

10-1-2009

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### Recommended Citation

Alan C. Swan, *NAFTA Chapter 11-"Direct Effect" And Interpretive Method: Lessons From Methanex V. United States*, 64 U. Miami L. Rev. 21 (2009)  
Available at: <https://repository.law.miami.edu/umlr/vol64/iss1/3>

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# ARTICLES

## NAFTA Chapter 11—"Direct Effect" and Interpretive Method: Lessons from *Methanex v. United States*

PROFESSOR ALAN C. SWAN†

### I. INTRODUCTION

This essay concerns *Methanex v. United States*,<sup>1</sup> an arbitral decision under Chapter 11 of the North American Free Trade Agreement (NAFTA).

Methanex is a Canadian company with two U.S. subsidiaries. It is the world's largest producer of methanol.<sup>2</sup> In molecular structure, methanol is an alcohol that, when reacted with isobutylene, provides the oxygen in MTBE, an ether. MTBE is then added to gasoline to form what is known as "reformulated gasoline." Under federal law, only reformulated gasoline with a specified oxygen content can be sold in designated urban areas with high levels of air pollution. Until banned, MTBE with methanol as its oxygen base, was the "oxygenate of choice" in California and elsewhere in the United States.<sup>3</sup> However, when traces of MTBE were found in groundwater, lakes, and reservoirs throughout California (principally due to leakage in underground gas station tanks) and when scientific studies by the University of California<sup>4</sup> confirmed MTBE as a

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† Professor Swan was working on this piece at the time of his passing. The University of Miami Law Review is publishing it to honor his memory and academic legacy. We have made every effort to preserve the original voice and meaning of the work, but we have not attempted to finish it. Any incompleteness of research is intentional. We want it to serve as a portrait of his work before he passed. The piece is meant to be a tribute to his life, his dedication, and his love for legal academia. He was an intellectual giant in his field and in our school, and he will be sorely missed.

1. *Methanex Corp. v. United States*, 44 I.L.M. 1345 (2005).

2. Methanex controls about seventeen percent of the global productive capacity of methanol *Id.* at 1368.

3. *Id.* at 1411. Neither the Clean Air Act Amendments of 1995 that introduced the requirement of reformulated gasoline (RFG) nor the EPA regulations requires the use of particular oxygenates. The requirement instead is for a stipulated oxygen content by weight, leaving it up to producers to choose the oxygenate. By 1999, while both MTBE and ethanol were being used in the production of reformulated gasoline, about eighty-seven percent of the oxygenate used was MTBE, largely by reason of cost, superior blending characteristics, and ease of transport.

4. California Senate Bill 521, enacting the MTBE Public Health and Environment Protection Act of 1997, signed into law October 8, 1997, directed the University of California to conduct

threat to California's water supply,<sup>5</sup> the State issued a total ban on the sale of gasoline with MTBE. The ban was effective December 31, 2003. Methanex responded by challenging the California ban in two separate damage claims totaling \$970 million under NAFTA Chapter 11.<sup>6</sup>

Chapter 11 confers on an investor from one NAFTA member with an investment in another the right to sue the latter in an arbitral proceeding for violating any rights conferred on the investor by that Chapter.<sup>7</sup> The suit is under either the International Centre for the Settlement of Investment Disputes (ICSID) or United Nations Commission on International Trade Law (UNCITRAL) rules, damages are the only remedy, and damage awards are enforceable under the New York Convention.<sup>8</sup> Borrowing from European Union parlance we call this feature of Chapter 11 a grant of "direct effect" to investor rights.<sup>9</sup>

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research "assess[ing] the risks and benefits to human health and the environment of MTBE . . . compar[ing] those risks and benefits to ETBE, TAME, and ethanol." The California Bill appropriated \$500,000 for that purpose. *Methanex*, 44 I.L.M. at 1410.

5. *Id.* at 1411.

6. *Id.* at 1345.

7. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993). The rights in question include "national treatment," (Article 1102), most-favored-nation treatment (Article 1103), freedom-from-specified-performance requirements (Article 1106), a prohibition on limiting the nationality of top management (Article 1107), and a prohibition on expropriating an investor's property, including any measure "tantamount" to an expropriation, unless for a public purpose accompanied by compensation (Article 1110). In addition, all investment earnings must be freely transferable in hard currency (Article 1109). *Id.* arts. 1102-1103, 1106-1107, 1110.

8. Note also that the ICSID Convention requires that national courts enforce ICSID damage awards issued against ICSID members. However, of the three NAFTA members, only the United States is a signatory to the ICSID Convention. This means that the ICSID arbitral rules can apply solely by operation of the ICSID Additional Facility Rules. Those rules, in turn, apply only in cases where one of the nation-states consenting to the arbitration is signatory to the ICSID Convention itself (i.e., only in cases brought by a U.S. investor against either Mexico or Canada or by a Mexican or Canadian investor against the United States). Cases brought by Canadian investors against Mexico and Mexican investors against Canada must proceed under the UNCITRAL rules. No provision is made in the Additional Facility Rules for domestic court enforcement of ICSID arbitral awards. In all cases, however, arbitral damage awards can be enforced under the New York Convention, to which all three NAFTA members are signatory. See generally INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, ICSID CONVENTION, REGULATIONS, AND RULES 73-128 (2006) (laying out the rules), available at <http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp>.

9. The seminal learning on "direct effect" is to be found in the work of the European Court of Justice (ECJ) pursuant to the EU treaties. Under those treaties, select treaty provisions may be the basis of individual suits against nation-state parties by actions in the national courts, with an appeal to the European Court of Justice. No provision is made for the submission of claims to special international tribunals like those established by NAFTA. For the present, however, while we are borrowing the European terminology, we must exercise great care in drawing parallels between Chapter 11 and the EU experience. The latter arises out of a unique political context that differs in marked respects from that in which the international economic system, including NAFTA, seen from a global perspective, now operates. As the ECJ in its seminal decision in the *van Gend & Loos Case* put it:

In its first claim, Methanex charged that the California ban was "tantamount" to an expropriation without compensation in violation of NAFTA Article 1110 and of customary international law applicable under Article 1105.<sup>10</sup> In a "Second Amended Statement of Claim" ("second claim"), Methanex added a challenge both to the science underlying the California ban and to the motivation for the ban. The company claimed that the alleged threat to the California ground water was nothing but a pretext for turning the substantial California oxygenate market over to methanol's principal competitor, ethanol. Ethanol is almost entirely of domestic origin. Methanol is largely from foreign sources. Hence, Methanex claimed the California ban on MTBE was a blatant act of discrimination on the basis of nationality and as such violated the "national treatment" requirement in Article 1102(1). In its second claim, Methanex also charged that the discrimination against methanol violated international law under Article 1105(1) and represented an uncompensated expropriation in violation of Article 1110(1).

In the end, the Tribunal issued two awards. The first, dated August 7, 2002, was a Partial Award on Jurisdiction and Admissibility. There the Tribunal dismissed both of Methanex's first claims under Articles 1105(1) and 1110(1) but judged all three of its claims under the "Second Amended Statement" provisionally within the cognizance—the jurisdiction—of Chapter 11. Nevertheless it ordered Methanex to produce new pleadings and a revised evidentiary submission. In the second and Final Award of May 23, 2005, the Tribunal, after hearing Methanex's revised proffer of proof and final argument, dismissed on their merits all three of Methanex's amended claims and concluded that none of those claims were within the cognizance of Chapter 11.

While the decision for the United States was, we concede, defensible, one must nevertheless hope that the Tribunal's literal, noncontextual formalist analytic method will not come to haunt future tribunals. Constrained by that method, the Tribunal, we contend, got the jurisdictional issue wrong with a decision, which, if followed, could seriously limit, if

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The objective of the EEC Treaty . . . is more than an agreement which merely creates mutual obligations between the contracting states . . . . [The] Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights . . . and the subject of which comprise not only Member States but also their nationals. Independently of the legislation of Member States, Community law therefore not only imposes obligations on individuals but is also intended to confer upon them the rights which become part of their legal heritage.

Case C-26/62, *N.V. Algemene Transp. en Expeditie Onderneming van Gend en Loos v. Nederlandse Administratie der Belastingen*, 1963 E.C.R. 3. No such claim can be made for NAFTA or, in fact, for any other multinational grouping within the international economy.

10. *Methanex*, 44 I.L.M. at 1345–46.

not emasculate, the scope of investor rights under Chapter 11. The Tribunal then erred in denying Methanex's claim charging the United States with violating the "national treatment" requirement of Article 1102(1). Captured by its narrow nonpurposive methodology, the Tribunal also passed up an important opportunity to reconcile environmental values with NAFTA's liberalizing objectives; arguably the central issue in the case.<sup>11</sup> Ironically, on this issue and this issue alone, the Final Award seems to offer sufficient factual material to sustain a decision for the United States. But there is scarce a word in the Award suggesting how or why NAFTA might make it so.

Furthermore, in our mind, the Tribunal correctly dismissed Methanex's claim that the California ban by reason of its discriminatory impact violated customary international law under Article 1105, but it did so for all the wrong reasons. Lastly, challenged to identify investor's rights under the expropriation provisions of NAFTA (Article 1110), the Tribunal reverts to a simplistic analysis that is likely to elicit from investors behavior precisely contrary to what the draftsmen sought to elicit in conferring on investors the rights enumerated in that Article.

For the Tribunal, *Methanex* was doubtless a difficult case. The case had evoked a highly charged political opposition, especially in California and among environmentalists.<sup>12</sup> Many, including lawyers for the United States, said that it was an unintended use of Chapter 11.<sup>13</sup> This climate may very well have created personal difficulties for members of the Tribunal. It may also have prompted a concern not to exacerbate the rather vocal opposition to Chapter 11 so as to further undermine what was already a rather politically fragile grant, a grant already under heavy attack from its anticorporatist critics.<sup>14</sup> But it is not for us to speculate.

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11. This is a case where the environmentally driven measure—a total ban on certain products—has had a dramatic effect on international trade. As such it is not, however, an example of what has popularly come to be called a "linkage" of trade either strategically or institutionally linked to environmental policies and actions that are quite separate from the trade policies and measures to which they are linked. See Joel P. Trachtman, *Institutional Linkage: Transcending "Trade and . . ."*, 96 AM. J. INT'L L. 77 (2002).

12. See Chris Mooney, *Localizing Globalization*, AM. SPECTATOR, July 16, 2001, [http://www.prospect.org/cs/articles?article=localizing\\_globalization](http://www.prospect.org/cs/articles?article=localizing_globalization); Sweet Liberty, *New Nafta Lawsuit Against the U.S.*, [http://www.sweetliberty.org/issues/nafta\\_gatt/lawsuit.htm](http://www.sweetliberty.org/issues/nafta_gatt/lawsuit.htm) (last visited Sept. 10, 2009).

13. Specifically what is meant by this accusation is never explained very well. As a result, one suspects that the expectations that the *Methanex* Case allegedly offended go back to a general sense shared by Congress and many in the executive that Chapter 11's sole purpose was to protect American and Canadian investors from irresponsible and potentially destructive regulation by Mexico. It never really entered the congressional or executive mind that Methanex, a Canadian Company, would turn this around and dare to challenge a regulation taken by the State of California with great procedural care, especially a regulation designed to protect the environment.

14. These groups tended to see every arbitral decision that ruled in favor of an investor as evidence that the grant of "direct effect" has become a measure driven by open hostility to

We are dealing with the work of a distinguished, highly competent panel whose sense of fairness and impartiality cannot be questioned. And in the end we don't need to speculate, for we have what we need, the actual words of the Tribunal in its Final Award. From those words, we can readily and unquestionably trace the Tribunal's default on both the jurisdictional and the substantive issues to its noncontextual formalist method of treaty interpretation.

We shall return time and again with proof of this last point. But first, it is important to recognize that in the *Methanex* case much more was at work than the fate of one Canadian firm injured by California's regulatory action. There was a certain juxtaposition. On one hand, there was NAFTA. Substantively based on measured neoliberal economic postulates, NAFTA is replete with integrative initiatives that challenge the very foundations of national economic sovereignty. It also brings a new, well defined measure of democratization to the regulation of the economic forces within its sphere. Despite its critics and its own self-imposed limitations,<sup>15</sup> NAFTA is a remarkably successful enterprise

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national health and safety measures, to labor rights, and to environmental regulations. On any of these grounds, it is argued, the grant per se poses an unacceptable danger to the public interest.

15. See KENNETH F. SCHEVE & MATTHEW J. SLAUGHTER, *GLOBALIZATION AND THE PERCEPTION OF AMERICAN WORKERS* 2, 30–32 (2001). NAFTA was only designed to generate wealth for the United States, not to govern or even influence the internal distribution of that increase. Yet, among the major challenges facing the United States is the need to reverse the wholly unacceptable and ultimately dangerous division that in recent decades has been growing between, on one hand, a small set of super-rich Americans combined with a somewhat larger upper middle class, for whom the American economy appears to assure a quite safe and comfortable living, and, on the other hand, a vast number of citizens who face an economic future that is indeed bleak. Lower middle class citizens who are part of a traditionally skilled blue-collar working class, together with a tragically growing number of citizens in or near poverty, make up this second group of citizens. Unfortunately, and quite erroneously, this growing schism has been blamed by some on the free trade agreements that America has made in recent decades such as the WTO agreements, NAFTA, Asean, and other similar bilateral and multilateral agreements. See *id.* at 90. While these trade agreements may have added to the complexity of the problem, they are not responsible for the lack of domestic measures that were otherwise necessary to guard against the growing disparity. Instead, they are part of the solution, not part of the problem. *Id.* at 10–11. It is clear that these agreements, including NAFTA, have added measurably to the aggregate wealth of the United States. If the people of the United States are ever to mount a serious assault on the growing disparity in the sharing of their wealth, increase in that wealth is vital. Inequality of wealth cannot be overcome unless there is added wealth to be distributed. Without a willingness to redistribute wealth, the effective reversal of the growing disparity between our citizens will quite simply be impossible. In this context, the arguable freeing of trade and capital movements through such measures as NAFTA is among the most critical tasks that the United States must undertake if it ever hopes to truly return the "American dream" to the reality it once was. Thus, one can appreciate the extraordinary importance to every person in the United States of the increase in wealth that the Peterson Institute for International Economics and others have estimated has resulted from the liberalization of trade and investments that the international community has achieved over the last several decades. As described by Scheve and Slaughter:

[T]rade and investment liberalization over the past decades has added between \$500 billion and \$1 trillion in annual income—between \$1,650 and \$3,300 a year for

when measured by the purposes for which it was intended. In all of this, it stands as harbinger of a new order for the governance of the global economy.

There is, however, a contrary tapestry composed of three elements all tied together by a strong, indeed rich, historical affinity. There is first a method of treaty interpretation, what we speak of as “noncontextual formalism.” Second, there is a contemporary concept of national sovereignty with its roots in the Westphalian settlements. Third, lies the “realist” school of international politics. Constrained by its interpretive method, the Tribunal’s rejection of *Methanex*’s substantive claims, its unfortunate jurisdictional ruling, and its failure to move creatively on the environmental and expropriation issues, served only to reify this historical triad. Indeed, if any broader lesson is to be learned from *Methanex*, it is how insistently the noncontextual formalist legal method employed by the Tribunal can, and often does, function as a first line of defense on behalf of traditional concepts of national sovereignty and realist international politics, and against the integrative and liberalizing reforms of NAFTA and treaties like it.<sup>16</sup>

More specifically, what we choose to call “noncontextual formalism” is essentially an aspect of traditional positivist jurisprudence. We chose the somewhat more elaborate designation only to highlight how our critique of the *Methanex* Award roots that decision in one particular aspect of positivism: namely, the view of law “properly so-called,” as a social construct derived from a starting point that places it at a remove from both morality and the values, objectives, and behavioral assumptions from which social policy is constructed.

Seen from this perspective the Tribunal’s work in *Methanex v. United States* was noncontextual formalism writ large. There is scarcely a word concerning the policy objectives of the relevant investor rights under NAFTA. Nor is there any evidence that those policies or the values that inspired them ever entered into the Tribunal’s deliberations. The latter reflect a conviction that law—as least in “pure” form—is an entirely self-contained social construct to which the larger social order is entirely exogenous. When a text is engaged, it insists upon subjecting that text to what it considers its own utterly autonomous formalistic interpretive discipline, its own “noncontextual formalism.” It is “formalistic” in the sense that it treats the text, in virtually its entirety, as a self

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every American. A Doha agreement on global free trade in goods and services would generate, according to similar studies, \$500 billion a year in additional income in the United States.

Kenneth F. Scheve & Matthew J. Slaughter, *A New Deal for Globalization*, FOREIGN AFF., July–Aug. 2007, at 34, 36.

16. Treaty Establishing the Caribbean Community, July 4, 1973, 12 I.L.M. 1033, 1036–37.

sufficient structure. It is "noncontextual" in that the words of the text, taken in what is thought to be their "ordinary meaning," are, at critical points, exegetically placed at a remove from the economic, political, and social realities that animated those words in the first place and out of which the objectives of the text were crafted. In this self-sufficient and autonomous posture, the system is, at times, passed off under the disastrously misleading notion of law as a science. This also means that the text is at times manipulated by a purportedly well-honed system of established canons. These are applicable not only to the immediate ordinance under scrutiny, but to all other ordinances without notable respect for their variable subject matter.

As the second member of the triumvirate there lies "realism." Realism offers a perspective on the political relationship between States and is an uneasy, yet historically frequent, companion of noncontextual formalist legal theory. Political "realism" starts with a strong tendency to see the relationship between States as rational and functionally uniform throughout the international system. It assumes that national preferences all range from survival to various modes of self-aggrandizement, and are exogenous and fixed. Added to this, it views the international system basically as anarchic, fraught with uncertainty requiring States to be constantly alert to the possibility of internecine conflict. To a "realist," in short, the international system is a collection of "billiard balls: hard, opaque, unitary actors colliding with each other."<sup>17</sup>

In accord with this metaphor, power is necessarily the currency of the international system. If, within this anarchic structure, nation-states are to enjoy even a modicum of peace and good order no one State can be allowed to become the dominant—imperial—power. The result is the so-called "balance-of-power," a system that does not seek "to avoid crises or even wars;" it does not seek "peace . . . [only] stability and moderation."<sup>18</sup>

Historically, despite the political "realists" tendency to disparage all international law,<sup>19</sup> the affinity between the "realist" vision of international politics and the noncontextual formalist theory of international law was both doctrinally and operationally palpable. To the lawyers, at least, the relationship between noncontextual formalist legal theory and "realist" political theory was captured largely through the notion of a "balance-of-power." It stood as the only ordering principle—the only

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17. Anne-Marie Slaughter, *International Law in a World of Liberal States*, 6 EUR. J. INT'L L. 503, 507 (1995).

18. HENRY KISSINGER, *DIPLOMACY* 20–21 (1995).

19. GEORGE F. KENNAN, *AROUND THE CRAGGED HILL: A PERSONAL AND POLITICAL PHILOSOPHY* 64 (1993); HANS MORGENTHAU, *POLITICS AMONG NATIONS* 12 (Kenneth W. Thompson ed., McGraw-Hill 1993) (1948).



generative force for law—that the inherently anarchic system of the international political “realists” was capable of sustaining. As Kingsbury points out, early Twentieth Century international noncontextual formalists such as Lassa Oppenheim thought of “the balance of power [a]s ‘a political principle indispensable to the existence of International Law’”; a “determina[nt] of law.”<sup>20</sup>

In no small part, this convergence reflected a belief, inherited from the Enlightenment, that the balance-of-power would tend toward the “common good.”<sup>21</sup> Yet, that faith proved “elusive in the century of almost constant conflict that followed the Thirty Years War”<sup>22</sup> but even more so in the horrors that marked twentieth-century wars. Too often the vaunted “balance” served only to cloak incursions by the powerful or to rationalize a war of all against all. In consequence, many of Oppenheimer’s successors, such as Lauterpacht and Brierly, appeared to retreat from the paradigm. Yet, just under the surface of the intersection where international politics in its “realist” form meets international law in its noncontextual formalist mode, lies both the anarchic conception of the international system and the balance-of-power as the principal ordering limitation upon that anarchy.

This affinity—this apparent intellectual convergence of the non-contextual formalist vision of international law with the “realist” conception of international politics—can be more fully demonstrated by examining the affinity between the noncontextual formalist view of law and the attributes of “national sovereignty” as developed following the Westphalian settlements. This we explore more fully in Part II below. For the present, the point to emphasize is the importance of recognizing how the Tribunal’s noncontextual formalist legal analysis in *Methanex* succeeded in working a virtually complete disconnect between, on one hand, the NAFTA text and, on the other hand, its reformative economic and political premises—its powerful integrative initiatives, and its pervasive democratic influences. By this disconnect, the Tribunal served only to defend traditional notions of national sovereignty and the realist conception of the international political order against NAFTA as the har-

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20. Benedict Kingsbury, *Legal Positivism as Normative Politics: International Society, Balance of Power and Lassa Oppenheim’s Positive International Law*, 13 EUR. J. INT’L L. 401, 417 (2002).

21. Kissinger’s characterization of the balance-of-power continues in the following terms: Intellectually, the concept of the balance of power reflected the convictions of all the major political thinkers of the Enlightenment. In their view, the universe, including the political sphere, operated according to rational principles which balanced each other. Seemingly random acts of by reasonable men would, in their totality, tend toward the common good.

KISSINGER, *supra* note 18, at 21.

22. *Id.*

binger of a new, more efficient, more inclusive, and hopefully more just global economic order.

Lastly, against the background of these three long-held theoretical attributes of the international community—"noncontextual formalist" legal theory, Westphalian based national sovereignty and "realist" political theory—we come to NAFTA Chapter 11 and its grant of "direct effect" to investor rights. That grant, if exercised free of noncontextual formalist constraints, offers a major challenge to the political "realists" paradigm. It begins to disaggregate that paradigm, to break open the "billiard ball." It explicitly draws into the confluence of a nation's foreign-policy deliberations, one part—albeit a small part—but nevertheless a part of the richly textured and ever-broadening web of a nation's cross-boundary relationships; relationships engaging private individuals, business establishments, labor representatives, national, state and local bureaucrats, NGO's, and other organizational alliances. But for the grant of "direct effect," participants in those relationships would have no voice in a member-state's foreign-policy deliberations except as they might penetrate a political filter and influence the nation's foreign affairs establishment—executive or legislative. Under the grant of "direct effect," on the other hand, the formulation and execution of a Member's foreign policy can begin to engage directly the highly diverse, intensely active, and broadly representative elements of a nation's domestic polity. When that engagement then occurs in the context of an agreement such as NAFTA, with its deeply integrative and reformative mandates, conventional notions of national sovereignty and of international relationships are drawn sharply into question.

## II. "REALIST" POLITICS, WESTPHALIAN SOVEREIGNTY, AND THE NONCONTEXTUAL FORMALIST LEGAL METHOD

Although not an easy concept, we can appropriately say that, in general, "sovereignty," reflective of its Westphalian roots, has today come to mean that the formal apparatus of the nation-state must (i) effectively exercise supreme political authority within a territory, (ii) possess a monopoly of the legitimate use of force within that territory, (iii) control its territorial boundary with reasonable consistency, (iv) conduct its internal affairs free from undue external intervention, (v) pursue a relatively independent foreign policy, and (vi) be recognized by other States as a member of the community of sovereign nation-states.<sup>23</sup>

Note first how far these postulates are given over to the task of vindicating the power and preemptive authority of the official nation-

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23. Rafael Leal-Arcas, *Theories of Supranationalism in the EU*, 8 J.L. Soc'y 88, 95 n.15 (2007).

state apparatus. Apart from bounding that power with the concept of territoriality, there is nothing that speaks to other subtler and equally vital attributes of nationhood: to history, cultural origins and traditions, language, forms of governance, communal allegiances, or to any other attribute upon which the official State apparatus might depend for legitimacy other than success in wielding coercive force. In this respect these postulates—these attributes of “sovereignty”—fit readily into the larger “realist” conception of the nation-State, the “billiard ball” of the international order.<sup>24</sup>

At the same time, viewed from a “legal,” rather than “political” perspective, these postulates constitute without doubt a legal ordering. These are the operative elements of a customary law. As such, they evince a strong affinity with the principal attributes of noncontextual formalist jurisprudence. This is not to suggest that the basic tenets of Westphalian sovereignty are product of formalist legal theory.<sup>25</sup> The contention is more nuanced. We claim only that certain of the Westphalian postulates reflect ideas concerning the internal order of nation-states and the dynamics of inter-nation-state relationships that, as statements of principle, can be reconciled with a noncontextual formalist theory of law more readily than with any other system of legal theory. In addition, apart from their roots in “realist” *political theory*, the Westphalian postulates owe much of their creditability to noncontextual formalist *legal theory*.<sup>26</sup> The latter has worked powerfully to reify those postulates.

From this perspective, consider first the Westphalian affirmation that to be “sovereign” the official nation-state apparatus must be the supreme political authority within a nation’s territory. This means being the supreme law giver within that territory. It signals a preemptive power. No values, principles, purposes, or social expectations from the larger economic, political, and cultural setting within which the institutions or individuals charged with applying the law operate can pass as

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24. Given its historical roots, this is all quite understandable. In signaling acceptance of a religiously diverse, multistate system in lieu of a broadly shared theological and cultural imperium, in responding to the devastation brought on by princely interventions, in articulating a theory of at least nominal equality designed to contain princely ambition through the balance of power, the Westphalian settlements were necessarily preoccupied with reifying the prerogatives of the State.

25. Quite the contrary. According to the political “realist” account of Westphalian sovereignty, cooperation between sovereigns is a transient matter and, as such, an elusive and unstable state of affairs—a state of affairs that necessarily marginalizes any influence that international law might have, reducing it largely to so many pious maxims contrived only to rationalize what can be achieved through power and power alone.

26. In establishing this linkage, the only manifestations of “noncontextual formalist” jurisprudence that concerns us here relate to the interpretive methodology used by courts, arbitrators, executive officers, and others charged with applying or otherwise interpreting the mandates of a legal text or of other authoritative sources.

law, or even help shape law, unless officially embraced by the authoritative organs of the nation-state.

This leads inexorably to the dominant propensity of noncontextual formalism. When asked to settle concrete issues of governance according to law, the only result that noncontextual formalism accepts as legitimate is a result explicitly or clearly implicit within what is thought to be the ordinary meaning of a norm—a rule or principle—laid down or adopted by the nation-state.<sup>27</sup> This holds true whether the norm is embodied in a constitution, in legislation, or in a judicial opinion or executive order issued in the exercise of constitutional or legislative authority.<sup>28</sup> And it is this basic tenet that, with varying degrees of intensity, manifests itself in the noncontextual formalist's reluctance to embrace results drawn from the purposes and informing values—the history, the psychological, political, economic, and cultural assumptions—that gave birth to or reflect the contemporary society mirrored in the official text, rather than from the "ordinary meaning" of the text itself. It reflects a tendency to deny that autonomous sources such as "natural law" or "community-wide values" or the "customs" of the community or the practices and expectations of functional groups within the community (e.g., merchants) could ever give definitive meaning to the text.<sup>29</sup> Above all else, noncontextual formalist dogma abhors any interpretive move that would go outside the word, outside the text—the official expression or its implications—even when necessary to keep faith with the core values embraced by the text.

This general methodological disposition applies not only to municipal law but also to international law whether it be a treaty—"conventional" international law—or a norm of customary law that qualifies as such under a strict application of *opinio juris*. The latter doctrine, strictly construed,<sup>30</sup> does in fact represent another point of affinity between legal noncontextual formalism and the political realist's paradigm. To the strict legal noncontextual formalist, no normative limit on the use of sovereign power—no law—could exist unless the sole legitimate purveyors of power had consented to the limit. Therefore, customary inter-

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27. Jonathon T. Molot, *Ambivalence About Formalism*, 93 VA. L. REV. 1, 46 (2007).

28. There is, of course, a formative process that must follow certain rules, what Henry Hart called the "rule of recognition": rules through which the lawmaker takes into account the stuff that goes into law. But that is not "law properly so-called" or the law of everyday that the courts, the executive, and the legal profession apply in execution of an official text.

29. Ely, writing about U.S. constitutional interpretation has very insightfully discussed this "noncontextual formalist" tendency under the label of "interpretivism." Although, as we hope to demonstrate, the *Methanex* Tribunal's version of "interpretivism" is far narrower and slavishly tied to a literal interpretation of the text than Ely's discourse would appear to allow. JOHN HART ELY, *DEMOCRACY AND DISTRUST* 1 (1980).

30. Consider an entirely revised notion of *opinio juris*, discussed *infra*.

national law, if it exists at all, must necessarily find its origin in sovereign consent. It could not be reflective of an overarching system of shared value expectations held broadly by the international community but to which no explicit consent could be traced (e.g., justice, fairness and equity, good faith, and transparency).

Take this one step further: consider the Westphalian prohibition against external intervention in the domestic affairs of a "sovereign" nation-state. Read this prohibition in light of the noncontextual formalist's insistence that only the explicit or clearly implicit postulates authored or endorsed by the formal apparatus of the nation-state can qualify as law, "properly so-called." The latter necessarily suggests that no moral or social value, as are found today, for example, in much "human rights" law, can be thought to justify an exception to the Westphalian prohibition on foreign intervention, unless that value can command the target nation-state's consent. In other words, no humanitarian or moral precept even if expressed or accepted through the agency of an *opino juris* can pass as international law unless backed by the target State's approval. More particularly, this rejection of any value-laden exception to the Westphalian prohibition on foreign intervention is reinforced by noncontextual formalism's traditional separation between law and morality.<sup>31</sup>

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31. Morality to most noncontextual formalists is very broad. It consists of sensitivity to right from wrong, to the stirrings of conscience, and common conceptions of decency and fair play. It consists also of cultural preconceptions and of the ways we identify the purpose or object of a human undertaking. More generously, it would appear to encompass every conceivable standard for judging human conduct that is not law. Noncontextual formalism's most distinguished contemporary exponent, H.L.A. Hart, has characterized the law-morality dichotomy as nothing less than a distinction between "law as it is" and "law as it ought to be." To appreciate how the noncontextual formalists employ this dichotomy one needs to consider their theory of sources. From whence does law emanate? There is Austin's now largely discredited theory of "sovereign command," Kelsen's "primary norm," and Hart's "rule of recognition." Within the deliberative processes implied by these sources, morality, broadly conceived, can play a decisive role. The guiding question is what "ought" to be the law. Under the aegis of that inquiry morality, the stirrings of conscience, right from wrong, purpose and social objective may be decisive. Yet, the workings of these sources are not law in the strict noncontextual formalist sense. They are not an authoritative pronouncement for the governance of society (except perhaps for the governance of those engaged in making law). They are instead a statement of how a rule or other pronouncement required to be taken by society as authoritative ("law, properly so-called") is to be conceived. On the other hand, once the sources of law have spoken, once the authoritative pronouncement has issued, then the dichotomy between law and morality—between the "law as it is" and the "law as it ought to be"—becomes fundamental to all that follows by way of application and enforcement of the authoritative pronouncement—to the process of bringing that pronouncement to life. For the judges, executive officials, administrators, all those charged with making the law a living presence in society, the first obligation is to "the law as it is." It is not for them to pick and choose according to what they believe the "law ought to be." Their obligation of fidelity to law is fidelity to the rule as it is given to them. In no small measure, the roots of this obligation lie in a desire to assure that "law and its authority" not be "dissolved" into one man's conceptions of what law and its authority "ought to be." For our purposes, however, the dichotomy is more far reaching. The

This is not to suggest that even as the Westphalian system was emerging during the seventeenth and eighteenth century, alternative legal theories were unavailable to ameliorate the harsh lessons of classic political "realism." In time, however, none of the alternative theories could break through the intellectual presuppositions that "realist" politics and ultimately legal positivism seemed to compel. Leo Gross, in an elegant essay, comments:

From the 18th century . . . there can be no doubt as to the trend of the development. It was predominantly positivist and consensual. The will of the states seems to explain both the contents and the binding force of international law. The concept of the Family of Nations recedes in the background . . . . Instead of heralding the era of a genuine international community of nations subordinated to the rule of the law of nations, [the Peace of Westphalia] led to the era of absolutist states, jealous of their territorial sovereignty to a point where the idea of an international community became an almost empty phrase and where international law came to depend upon the will of states more concerned with the preservation and expansion of their power than with the establishment of a rule of law.<sup>32</sup>

One can readily understand the difficulties of formulating a foundation for the orderly and predictable conduct of human affairs in a world of powerful, ambitious, and oft-times ruthlessly warring nation-states. Some, the "neorealists" for example, say it is theoretically impossible.<sup>33</sup> Certainly, no system is credible if it refuses to acknowledge that a nation's raw military, economic, and political power can be at work in influencing the quality and shaping the direction of its relations with other nation-states. One can also understand how, under these constraints, the possibilities for international law may be thought to exist only in the case of those normative postulates to which nation-states have, in a strict sense, given their consent. No less understandable is

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reader will appreciate that behind the dichotomy between "law as it is" and "law as it ought to be" lies a certain distinctive conception of language. To the noncontextual formalist there is within most, if not all, coherent authoritative pronouncements a "core" of meaning—a statement of what "the law is"—that can, through a determined nonpurposive inquiry using deductive or analogical reasoning be applied to new situations relatively free of doubt and without seriously engaging any question of morality—of what the "law ought to be." Where this is not the case, where a new situation arises to which the application of the rule remains indeterminate, and where, despite a rigorous use of deductive or analogical reasoning, the rule must be interpreted—where the case falls within the "penumbra" of the rule—then, and only then, to some but not all noncontextual formalists is the question of what the "law ought to be" relevant. In this narrow setting the interpretive task, to the noncontextual formalist, becomes unequivocally law making—an exercise of the legislative power.

32. Leo Gross, *Peace of Westphalia, 1648–1948*, 42 AM. J. INT'L L. 20, 37–38 (1948).

33. See, e.g., RICHARD A. POSNER, *THE PROBLEMATICS OF MORAL AND LEGAL THEORY* (1999); Richard Rorty, *Dewey and Posner and Moral Progress*, 74 U. CHI. L. REV. 915, 921 (2007).

why that consent must be confined to the "ordinary meaning" of the words of a text read in accord with some overarching and consistent interpretive methodology that will guard against the temporizing influences of the various political, economic, and cultural circumstances that occasioned the need for consent or from the political and economic idiosyncrasies of the individuals called to judge that consent. Only literal applications, it may be thought, offer that degree of predictability necessary if jealous States are to be induced by treaties and other modes of international cooperation to relinquish the possibilities for unilateral action.

But in the end this view is deceptive. There is another side to it. The search for predictability in any legal system can quickly start one down a very short road to a loss of legitimacy if it results in a lack of attention to the fundamental economic and political purposes and social values used to justify the system. It is also true, especially in the international economic sphere (but elsewhere as well), that international law, its precepts, methods, and institutions, are reaching out to bring more and more of the world's transnational relationships under normative constraint. Whatever else "globalization" may entail, among its principal causes is the extraordinary expansion of international law in recent decades.<sup>34</sup> In consequence of this, but without pretending to offer a comprehensive answer to either noncontextual formalist interpretive theory or to the "neorealist" theoreticians, this essay offers just one case, the *Methanex* case under NAFTA; a case the errors of which show rather dramatically how the grant of "direct effect" can, when properly used, undermine noncontextual formalist interpretive theory, disaggregate the political realist's paradigm, challenge conventional notions of sovereignty, and, in each of these ways, contribute to the developmental and reformative objectives of NAFTA and other ventures in international cooperation. By this case study one may hopefully begin to appreciate the threat to cooperative international ventures posed by the literal nonpurposive (noncontextual formalist) methodology that so decisively shaped the *Methanex* decision.

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34. Perhaps the most dramatic expansion occurred when the GATT was superseded by the WTO. In addition there has been a virtual explosion in free trade agreements and investment agreements between developed countries such as the Treaty of Rome, the EFTA, The Canadian-United States Free Trade Agreement, and a growing number of such charters between developing countries, including the numerous agreements between Latin American and Caribbean countries and between African countries and by developing countries with industrialized nation-states, including the ASEAN agreement, the Bilateral Investment Treaties and the various iterations of the Lome Convention.

### III. "DIRECT EFFECT": A MODEST REFORM

Traditionally, with few exceptions, only sovereign nation-states had standing to adjudicate questions of international law in international tribunals. That remains true today although with increasing exceptions.<sup>35</sup> This situation has persisted even when the dispute at issue concerns agreements intended to protect private interests. In general, private parties have to await governmental action—usually by their own government—for vindication of their rights. Plainly, Chapter 11 challenges this tradition.

It is, of course, true that only nation-states, by treaty or other agreement, can confer on private parties the right to compel a nation-state to answer in an international forum for alleged violations of the agreement.<sup>36</sup> When, however, a dispute does arise the grant of "direct effect"

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35. This applies to the International Court of Justice ("ICJ"), *see* *Barcelona Traction, Light & Power Co. (Belg. v. Spain)*, 1970 I.C.J. 3 (Feb. 5), as it did to its predecessor, the Permanent Court of International Justice ("PICJ"). It also applies to the dispute resolution panels and the Appellate Body of the WTO. It also applies to the Law of the Sea Tribunal, among the most prominent permanent international tribunals. *See* *United Nations Convention on the Law of the Sea*, Dec. 10, 1982, 1833 U.N.T.S. 3, 98. Not until the truly innovative decisions of the ECJ giving "direct effect" to provisions of the Rome Treaty was there any post-World War II international tribunal with permanent standing in which private parties could adjudicate claims against governments for the violation of their rights under international law. The decisions of the ECJ, however, arose, as we have already seen, out of a unique political context that differs in marked respects from that in which the international economic system seen from a global perspective now operates. Nothing nearly as structurally far-reaching can be said about any other international grouping, regional or otherwise, including NAFTA. The first step in the same general direction after the ECJ decisions was the movement toward the negotiation of Bilateral Investment Treaties ("BITS"). Under the earliest versions of the BITS, claims by a private investor from one Nation-state Party that the other nation-state Party had violated the investor's rights under the treaty were subject to private–nation-state arbitration. Later versions of these treaties often provided for arbitration under ICSID rules. By the end of 1965, however, only fourteen such treaties by Germany, ten by Switzerland, and one each by France, Italy, and the Netherlands with developing countries had come into force. Much later, in the 1980's and 90's the BITS movement gained substantial momentum although, until very recently, the number of cases brought by investors under those agreements has been quite limited. *See* UNITED NATIONS CTR. ON TRANSNATIONAL CORPS., *BILATERAL INVESTMENT TREATIES* 129, 154 (1988) (list of BITS concluded prior to 1987). In 1966, the Convention establishing the International Centre for Settlement of Investment Disputes ("ICSID") came into force. *See* *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, § 1, art. 1, *convention approved* Mar. 18, 1965, 17 U.S.T. 1270 [hereinafter *Investment Disputes Between States*]. Later in 1978 came the Additional Facilities Rule. Currently, nation-states are signatories to the ICSID Convention. In 1980, the Iran-United States Claims Tribunal was established. While standing in the long tradition of ad hoc tribunals for the adjudication of international claims, the Iran-United States Claims Tribunal nevertheless represents a systematic and significant effort to use private–nation-state adjudication through arbitration in dealing with the massive economic dislocations occasioned by the Iranian Revolution. *See* *City of the Hague, The Iran-United States Claims Tribunal*, June 2008, <http://www.denhaag.com/default.asp?id=476>.

36. It should be understood that we use the word "treaty" in a generic sense to include all comparable agreements, covenants, conventions, etc.



formally removes one nation-state from the dispute altogether, reducing or eliminating its power to shape the outcome. Even if the State retains some capacity to influence the outcome, formally the private party alone decides whether to invoke the international adjudicative process established by the treaty. The private party controls which of the treaty rights are to be asserted in that process, the legal theories employed in support of those rights, and the arguments used to sustain the theories chosen. The private party is responsible for the way the claim is pleaded—for all strategic and tactical decisions. In agreement with the respondent nation-state, the private party has the final say on whether to settle the dispute and to make that decision irrespective of what its own nation-state may consider politically expedient.<sup>37</sup> The grant of “direct effect,” in other words, draws private interests—both individual and institutional—into the multinational social order created by a treaty in a far more direct fashion than would otherwise occur under a traditional government-centered negotiating or adjudicative paradigm.

Moreover, as we shall see, that grant has powerful implications albeit with a limited scope. Not surprisingly, therefore, a contentious and quite-sophisticated debate has arisen over whether and under what conditions, if any, “direct effect” should be adopted as a mode of dispute settlement in trade and other like agreements—a mode to accompany the more familiar forms of diplomatic negotiation and government-to-government adjudication.

It is not, however, our intention here to enter that debate in any systematic way. We deal only with “investors’” rights and do not address any broader scope that the grant may have by reason of Article 1105.<sup>38</sup> Nor do we judge what effect the grant may have, if any, on Chapter 11 as a deterrent against breach of its mandates or as an inducement to comply with those constraints. We do not consider any possible interplay between the grant and governmental efforts to either adjudicate or negotiate the settlement of a claim. These are all questions for another day. Here we take only the first vital step in that discussion. Against a general background of the systemic challenges that “direct effect” can bring to “realist” politics and traditional notions of sovereignty, and the

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37. The points made here are probably equally applicable to adjudication based solely on customary international law. But a grant of “direct effect” to the substance of that law would doubtlessly require some form of treaty or other agreement between States. Nevertheless, in shaping the substantive content of that law, the tribunal to whom the adjudication is assigned may generally be thought to play a broader role than it might in shaping the substantive content of a treaty or other international agreement. NAFTA takes this step in Article 1105. It assimilates into the treaty regime at least some postulates of customary international law.

38. We deal only with the explicitly identified offenses listed in Chapter 11 and respect the limitation that the ITC has imposed on Article 1105 as a reference solely to violations of “customary international law.”

values inherent in those challenges, our interest is confined to evaluating the interpretive methodology used by the *Methanex* Tribunal in executing its mandate; nothing more than that.

Consistent with this limited purpose, we nevertheless must address one major argument against giving "direct effect" to investor rights under economic agreements. It is an argument for confining dispute settlement under those agreements exclusively to diplomacy or to government-to-government adjudication. It is also an argument for diplomatic flexibility and is critical to our present purposes because it engages the methodological issues central to this essay.

The argument for diplomatic flexibility builds on the fact that cases can certainly arise where a private investor's suit against a foreign government for violation of the investor's treaty rights could seriously embarrass the foreign relations or other, larger national interests of the investor's own country. Whether this is likely to occur in any case is usually a matter for the executive to judge. Having said that, however, it does not mean that the executive's preference necessarily serves the nation's public or national interest. One cannot assume that the executive necessarily speaks for the public interest when, in the exercise of discretion, it either refuses to pursue or it bars others from pursuing a negotiated or litigated solution to a controversy; a point to emerge dramatically from *Methanex*.

Time and again in *Methanex*, the United States, represented by the State Department's Legal Advisor's Office, favored arguments over a wide range of issues whose chief and sometimes only virtue lay in advancing the State Department's interest in winning the case for the United States as the respondent. These arguments served only a narrowly bureaucratic "state interest" not unlike that of a lawyer defending a private client at all costs. Lost, time and again, from the Legal Advisor's argument was the "public interest" of the United States in the economic and political goals that the framers of NAFTA had in mind in granting investors' protection or in attempting to strengthen governance of the international economy. Repeatedly, the Legal Advisor's Office appeared to have opted for a narrow bureaucratic "state interest" far removed from the "public interest" mirrored in the economic, political, and social context that captured the public consensus leading to the adoption of NAFTA.<sup>39</sup>

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39. Perhaps this posture is endemic to any executive when called upon to respond to charges that its government has violated a treaty or other agreement. That possibility, however, is well beyond the reach of this essay for, if true, it might be thought to cast new light on the use of an independent international tribunal to settle all disputes of this nature. That issue, of course, would take us far-a-field of our present agenda.

There is, of course, no intention here to suggest that executives cannot or do not, at times, speak out of a genuine “public” concern to avoid the adverse consequences that a law suit against a foreign government may have for a nation’s foreign policy. Nor do we deny that a private suit can, on occasion, gravely complicate the executive’s ability to pursue that policy effectively.<sup>40</sup> It does remind us, however, that perhaps endemic to the government lawyers’ situation is a conflict between the lawyers’ personal bureaucratic interests and the larger “public interests” with which they are charged. Until some form of institutional or principled mediation is devised, there is no reason to believe that an executive with complete discretion can be any more reliable as a purveyor of the public interest than was the State Department in its *Methanex* performance.<sup>41</sup>

The implication is suggestive. On one hand, grants of “direct effect” can adversely affect the foreign policies of an investor’s own government. On the other hand, those grants, when properly exercised, can very substantially benefit governance of the global economy. While this intuitively suggests something of a highly contestable trade-off between the two, one should, for the moment, consider the possibility of a more nuanced choice.

Even if an investor with a claim against a treaty partner chooses to invoke the right to sue the latter, the investor’s government is not barred from attempting to persuade the investor to either drop or delay the suit in the interests of its nation’s foreign relations. And it cannot be thought that such appeals lack force. If the situation posited by the government is credible, its argument persuasive, the private investor may very well find its own interests served by heeding the government’s plea. This means that in drafting the agreement the treaty maker’s choice to either grant or deny investors a right of private suit reduces to two alternatives.

If the agreement confers no right on an investor to sue—contains no grant of “direct effect”—and if, in any particular case, a government views the investor’s dispute with a foreign government as disruptive of its interests, we can, indeed must, assume that government will do nothing—by espousal or otherwise—to advance the investor’s interests. This

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40. We acknowledge that where the grant of “direct effect” is unrestricted, as in *Methanex*, the executive will have to rely solely on its power to persuade the private interests involved to withhold taking action. This, however, is not an inconsiderable power in the hands of a government prepared to use that power.

41. Possibly, this posture by an executive is a natural response to the exigencies of the intense, adversarial atmosphere that a grant of “direct effect” can engender. But query whether the exigency is any less when the executive must rely exclusively on diplomatic negotiations in a setting where its own legislature, the press, an entire industry, and the foreign investment community are looking over its shoulder.

effectively means that without "direct effect" the public's interest in treaty compliance and the private investor's personal interests will almost certainly be subordinated to whatever interests—"narrowly bureaucratic," "broadly public," or otherwise—that the executive chooses for that moment. On the other hand, if the investor's rights are given "direct effect," then either (i) the private investor will find the government's fear of policy disruption persuasive and the broader foreign-policy interests of the nation will prevail or (ii) the investor will ignore the government's fears, pursue its treaty rights and the "national interest" in treaty enforcement will prevail, whether the private investor wins or loses its case. Paradoxically perhaps, only with the grant of "direct effect" can the national interest be assured. It will be either the broader foreign-policy interests of the nation or the nation's interest in treaty enforcement, the latter a second best "national interest" perhaps, but certainly preferable to the interests identified by an executive constrained to replicate the State Department's *Methanex* performance. At the same time the lesson for us is clear; the more favorable—second best—interest is utterly dependent on the tribunal's loyalty to the purposes of the treaty in question and to the economic, political, and social values underlying those purposes.

This background, in turn, should make it manifestly apparent that grants of "direct effect" properly executed can reformulate the place that private claimants and their interests play in the ordering of global economic affairs. Among other effects, they can expose all components of the respondent nation-state's bureaucracy to the strictures of international law in a far more immediate way than would otherwise occur. They can induce greater bureaucratic sensitivity to international law even among those agencies with an exclusively domestic competence and can enhance cooperation among similarly situated regulatory agencies in the member nation-states. "Direct effect" can also supply an added and possibly readier entrance point for NGOs and other civic organizations into a nation's foreign-policy discourse. Although of limited scope when compared with the whole panoply of its members' foreign relations, a grant of "direct effect" to investors' rights definitively disaggregates the traditional realist conception of the nation-state in its international relations, the "bowling ball" of the metaphor. It moves all investors within a nation-state potentially caught up in a transnational dispute on a trajectory with far greater affinity to contemporary "liberal" international political theory than to anything the political realists would recognize.

The most salient of the "liberal" theorists' principles for our purposes lies in the recognition that a nation's foreign policy tends to be

influenced as much by the demands of its domestic polity, however varied and fractured those demands may be, as it is guided by the possibilities inherent in some abstraction mirroring a nation's political, economic, and military power in relation to that of other governments.<sup>42</sup> Contrary to the realist metaphor, the nation-state is neither "opaque" nor a "bowling ball." The frequency and level at which nations today intrude into each others' domestic affairs, the ever expanded web of international commitments, and the increasing scope and depth of daily contacts—both private and public—signals a level of interaction at which all "foreign policy," at least for a democracy, is as "domestic" as it is "foreign." Virtually any decision involving significant resources—public or private—originating in one country can visit adverse consequences on other countries severe enough to evoke from the latter a response jeopardizing the very objectives that prompted the originating decision in the first place. In a world wired in this intensely interactive manner, choices can be painfully difficult, engaging the interests of the entire society. Who domestically must bear the burden of change—the loss of jobs or of an entire business—necessary to garner the welfare gains that international comparative advantage makes possible? When should potential increases in national wealth from international trade and investment be compromised by a concern for the domestic distribution of that wealth or by other pressing domestic priorities? When, if at all, should domestic political stability be preferred over international demands for internal political and social reform? Where is the line between committing to international cooperation and reserving the freedom to act unilaterally?

In the end, answers to these questions—to foreign policy—involve a complex dialog between potentially multiple domestic coalitions, between individuals and groups with differing interests and differing principles brought together in support of some discrete objective. Common interests must be clearly identified. But no less important are the concepts, the ideas, the principles, even the rhetoric necessary to identify and cement a sense of shared purpose. So much so that success for any international venture, especially in the case of a comprehensive reformative treaty such as NAFTA, can depend as much on skill in managing domestic interest-group politics as on manipulating the economic and military power of the nation.

Treaty interpretation in this complex and uncertain milieu is profoundly ill-served by the *Methanex* Tribunal's jurisprudence. And the critical message to emerge from *Methanex* is that the interpretive task, at least in the case of a broadly reformative agreement such as NAFTA, is

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42. Scheve & Slaughter, *supra* note 15, at 38.

not bounded by its words but by the objectives it was intended to serve—its purposes—and the underlying economic, political, and cultural values necessary to a fuller understanding of those purposes.<sup>43</sup>

This is so by the very nature of the case. NAFTA is a regime with a distinctive political and economic and, to some, controversial orientation containing a plethora of domestically intrusive norms. Nothing can more surely undermine the creditability and consequent political support for such a regime than if, in the course of its implementation, the coalitions—both domestic and foreign—that gave it life withdraw their support. And nothing will secure such defections more rapidly than if, when challenged by the inevitable opposition to the treaty, tribunals charged with settling disputes over meaning fail to fulfill its supporters' expectations, expectations defined not by the words of the treaty but by the ends it was designed to serve. Purpose, not words, is the talisman of legitimacy for the interpretive enterprise.

On occasion, the outcomes required by a treaty text are, of course, reasonably discernable by nothing more complex than assigning to the words used such meaning as the interpreter can identify as "ordinary" usage. But this is infrequent. Too often words are burdened by a disarming encounter with either reality or the inventive power of one's protagonist. Most often one can reliably find a treaty's mandate only after all forms of conduct that its words can rationally entertain are tested against the reading most likely to serve the treaty's larger objectives. Even then one may have to choose between contradictory imperatives. Moreover, a usable portrait of the treaty's objectives may depend upon understanding the underlying political, economic, and cultural assumptions at work in that design. For in the end, the social forces whose ordering is the object of law are, by definition, entirely endogenous to anything that may be called law. This also means that, not infrequently, when careful attention to words yields no discernable course of action, the treaty's purposes must still be followed. There is no escape from purpose. No *lacuna* in the text can offer an escape. A refusal to decide because the necessary

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43. Irrespective of how one judges the wisdom of it, NAFTA was, in fact, built upon strong yet measured neoliberal economic postulates. In its origins, the Agreement reflected a widely shared belief that national economic progress could best be assured by a system in which resources moved internationally according to the dictates of open and competitive markets operating under the watch of carefully calibrated government regulation. In this respect, NAFTA owed much to its antecedents in the Canadian-United States Free Trade Agreement and to the Presidential decrees opening portions of the Mexican economy to foreign trade and investment. Regardless of how one assesses the accomplishments of NAFTA in the years following its inauguration, in its origins, NAFTA mirrored what was widely assumed to be the lesson of the 1980's—the utter failure of Latin America's experiment with autarkic, import-substitution policies compared with the highly successful East Asian commitment to open markets.

words are absent, risks affirmatively deciding what purpose would otherwise reject.

The larger import of these interpretive nuances as applied to investors' rights under Chapter 11 are best seen in relation to the "national treatment" requirement of Article 1102(1),<sup>44</sup> the Article principally relied upon by Methanex in its claim against California's MTBE ban. For reasons discussed later, "national treatment" is a constitutive element—a systemic piece—critical to the very structure of the emerging international economic order. It is also one of NAFTA's most intrusive challenges to the traditional Westphalian conception of sovereignty.<sup>45</sup> Its importance in both respects is underscored by the grant of "direct effect." That grant represents a deliberate effort to achieve a more extensive enforcement of the "national treatment" requirement than would otherwise occur if that requirement were left solely to diplomatic maneuver or government-to-government adjudication. Weiler captures the point nicely in discussing the impact that "direct effect" has had on the enforcement of the European Union treaties. He states:

Effectively, individuals in real cases and controversies . . . became the principal "guardians" of the legal integrity of Community law within Europe similar to the way that individuals in the United States have been the principal actors in ensuring the vindication of the Bill of Rights and other federal law.<sup>46</sup>

If NAFTA Chapter 11 parallels the European experience, if "direct effect" signals a design to intensify enforcement of the substantive provisions of that Chapter—most especially the "national treatment" requirement—nothing would frustrate that design more surely than for arbitrators to crib the scope of that requirement—its jurisdiction—within the bounds of a narrow literal reading impervious to its more ambitious purposes, to read it as the *Methanex* Tribunal read it.

This propensity raises yet another point. Intensified enforcement means more frequent claims and more frequent judgments, building, as a consequence, a body of precedent, even if not labeled as such.<sup>47</sup> Prop-

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44. Article 1102(1) provides as follows:

Each party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investment.

North American Free Trade Agreement, *supra* note 7, art. 1102(1).

45. Most notably the "national treatment" requirement is potentially at least a major roadblock to national programs to improve the competitiveness of domestic industry and service establishments.

46. J.H.H. Weiler, *The Transformation of Europe*, 100 YALE L.J. 2403, 2414 (1991).

47. While decisions by individual Tribunals legally obligate only the parties to the arbitration and have no formal controlling effect on subsequent tribunals, they inevitably become part of the

erly done this should lead to an increased refinement in the law and to rendering the law more responsive to the treaty's guiding purposes and adding importantly to both the flexibility and the predictability of the law. This is in sharp contrast to the limited opportunity that government-to-government adjudication presents for a reasoned interpretation of a treaty or other agreement by independent authority. And, certainly, interpretations propounded in the course of a contentious diplomatic negotiation are likely to be viewed as so self serving as to lack all but the most limited creditability. In short, a grant of "direct effect" is more likely to provide that systematic flow of reasoned explication that alone can bring predictability and, as a consequence, acceptance to a very generally worded text as a legitimate ordinance of government. Paradoxically, perhaps adjudication between investors and nation-states may prove as or more effective than government-to-government litigation or diplomatic negotiation in addressing the so-called externalities problem—the problem that a divergence will arise between a reading of the text favored by the litigating investor and a contrary reading favored by a wider community of other similarly situated investors.

Enhanced predictability can also help guard against that undisciplined bias in which some fear tribunals will engage if left free to follow an open and liberally purposive interpretive method. Enhanced predictability can also garner increased political support for the treaty from those domestic groups whose interests it serves and can play directly into the political dynamics—the coalition building—essential to continued political support for the integrative venture represented by the treaty. But once again all of these benefits depend utterly upon arbitral decisions "properly done," decisions that are seen to keep faith with the economic, political, and societal goals that prompted support in the first place and upon which continued support depends.

Lastly, a point of history emphasizes the importance of legal method. Irrespective of how one judges the wisdom of it, NAFTA was, as already noted, built upon strong yet measured neoliberal economic postulates.<sup>48</sup> In this respect, it owed a great deal to the Presidential decrees that, prior to NAFTA, opened much of the Mexican economy to foreign trade and investment. Yet, embodied only in Presidential decrees the reforms were vulnerable to later domestic political opposition—opposition sure to come. Accordingly, it was thought that casting

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treaty's *acqui* and are often followed by later tribunals who in assaying the substantive persuasiveness of the prior decision and their willingness to follow it are not unaffected by the fact it has emanated from a formal adjudicative authority.

48. It reflected a widely shared belief that national economic progress could best be assured by a system in which resources moved internationally according to the dictates of open and competitive markets operating under the watch of carefully calibrated government regulation.



NAFTA's liberal reforms in treaty form would provide a vital measure of protection against that opposition. Legislative ratification of the treaty would provide a democratic imprimatur, which the Presidential initiatives lacked while a domestic political attempt to undo NAFTA's reforms could be countered as an embarrassment to relations with powerful treaty partners.

Patently, this stratagem rendered NAFTA vulnerable especially to antiglobalization ideologues who would charge that NAFTA was nothing but a cynical contrivance designed to take from the people of North America the power to govern their own economies—nothing but a naked projection of power by special corporatist interests devoid of all democratic legitimacy.<sup>49</sup>

The truth, however, is more complex. NAFTA is a special contrivance. It is driven by the rapidly emerging reality that, if regulatory control of any nation's economy is to be genuinely democratic, that control must extend to as wide a segment as possible of the polity affected by that economy, irrespective of citizenship or where it may live. From this viewpoint, NAFTA does indeed change things. It subjects each member nation-state to a system of rules legally enforceable by arbitration<sup>50</sup> and designed to eliminate or at least limit a vast array of harms that one member nation-state can visit on another. Embodied in a treaty, the rules also have a certain moral force capable of influencing any diplomatic dialogue premised on their mandates. In this way, NAFTA, and treaties like it, bring new meaning to the concept of democratic legitimacy. With rules consented to by representatives of the member nation-states freely chosen by the people of those nation-states,<sup>51</sup> NAFTA begins, in a very modest way, the as yet unfinished task of assuring that in so far as possible the people who must bear the consequences of economic activity have, through a system of rules formed with their consent, a shared power of governance over that activity exercised without regard to the member nation-state in which they happen to live. In a real sense NAFTA is a transnational construct boldly transcending the limits of Westphalian sovereignty to democratize the governance of economic forces that otherwise out-run the capacity of individual nation-states to control.

Set in this context, Chapter 11's grant of "direct effect" to investor rights takes on special significance. It puts the power to initiate and

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49. See generally NOAM CHOMSKY, *PROFIT OVER PEOPLE* (1999) (criticizing neoliberalism).

50. This is primarily government-to-government arbitration under Chapter 20 but includes private-nation-state arbitration in the case of investor rights.

51. Citizens of complex democracies like the United States, Canada, and Mexico should certainly understand "representative democracy" and respect its extension to the international sphere.

materially control enforcement of the rules at the disposal of the very people intended to be protected by them. It is unlike the case where nation-state-to-nation-state settlement, through adjudication or diplomacy, is the sole mode for enforcing internationally mandated individual rights. Under those modes, the destruction of investor rights and of the hopes and aspirations that go with them, the pain, the loss, the degradation, and the injustice suffered, can be remedied, if at all, only if the individual succeeds in working through some bureaucratic or political filter—only if they succeed in persuading their own bureaucratic or political establishment that their claim is a matter of collective concern or they succeed in bringing political influence to bear on that same establishment. Not so, when the individual has at his or her disposal both the right and the remedy or has, under a grant of "direct effect," power to by-pass the filter.

This, in turn has further democratic implications. An independent judiciary is an essential cornerstone of a working democracy. A "day in court" has, for the vast majority of citizens, become the most immediate and visible entrée to the power required to vindicate its rights. In consequence, access to judicial assistance has become an utterly vital aspect of the democratic ethos. Thus it is that, in the case of a treaty with a reformatory agenda and democratic credentials, "direct effect" works an immediate devolution of those reforms to all members of the expanded polity who can bring themselves within the treaty's mandates. It brings to the treaty's democratic pretensions—to the expanded polity—a vitality that no diplomatic process or nation-state-to-nation-state adjudication can mobilize. Yet, once again, access to power has no meaning unless the arbitral or judicial tribunals charged with dispensing that power keep faith with the purposes—the social objectives—sought to be achieved by the grant of power in the first place.

#### IV. METHANEX'S "NATIONAL TREATMENT" ARGUMENT AND THE TRIBUNAL'S PARTIAL AWARD ON JURISDICTION AND ADMISSIBILITY

Methanex's most telling claim was that California's ban on MTBE violated the "national treatment" requirement of Article 1102(1). In this Part, therefore, we elaborate the argument propounded by Methanex and then take a step back to where the United States challenged the Tribunal's jurisdiction to hear any of Methanex's claims. We do this because there is very good reason to speculate that the Tribunal's Partial Award on Jurisdiction decisively influenced its Final Award on the merits. The latter, issued nearly three years later, denied all of Methanex's claims including its Article 1102(1) claim. Once we have analyzed the ruling on

Jurisdiction, we shall turn, in Part V, to the decision on the merits of Methanex's Article 1102(1) claim. This will be followed in Parts VI and VII by the Tribunal's decision to dismiss, on the merits, both the Article 1105 (violation of international law) and the Article 1110 (expropriation) claims.

(a) *Methanex's "National Treatment" Argument (Article 1102(1))*

Article 1102(1) of NAFTA provides as follows:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.<sup>52</sup>

In developing its case under this Article, Methanex established that between 1993 and 2001 MTBE, with its methanol base, was clearly the oxygenate of choice in the United States as in California. In 1998, California alone accounted for 132,000 tons of Methanex's MTBE shipment.<sup>53</sup> Only thirty percent of the methanol needed to produce the MTBE consumed in California was produced in the United States, while seventy percent came from abroad.<sup>54</sup>

Methanex argued that its principal competitors in the California market for gasoline oxygenates were U.S. ethanol producers who were, as competitors, domestic investors "in like circumstances" with Methanex. Made from biomass feed stocks such as corn and other materials,<sup>55</sup> ethanol was on occasion used to produce ETBE, an oxygenate in ether form similar to MTBE. Far more frequently, however, ethanol was added directly to gasoline through what is called "splash-blending," a process that, under federal law,<sup>56</sup> could not be used to blend methanol directly into gasoline.<sup>57</sup> In short, to produce "reformulated gasoline," ethanol, as a source of oxygen, was most frequently blended directly into gasoline, while methanol, also a source of oxygen, was first reacted with isobutylene to produce MTBE, which was then blended into the gasoline.

Despite this difference in production method, Methanex argued that

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52. North American Free Trade Agreement, *supra* note 7, art. 1102(1).

53. Claimant Methanex Corporation's Draft Amendment Claim at 5, *Methanex Corp. v. United States*, 44 I.L.M. 1345 (2005) [hereinafter Draft Amendment Claim].

54. Claimant's Reply to the Statement of Defense at 3, *Methanex*, 44 I.L.M. 1345.

55. *Methanex*, 44 I.L.M. at 1368.

56. *Id.* at 1446.

57. Methanex claimed that methanol, like ethanol, could be used directly as a gasoline oxygenate—a point contested by the United States. *Id.* at 1368. The United States also pointed out that such use was prohibited in the United States by federal law.

methanol and ethanol "compete[d] for customers in the [same California] oxygenate market."<sup>58</sup> Since, competition was the most widely recognized test for determining whether investors were "in like circumstances"<sup>59</sup> under Article 1102(1), California's ban on MTBE, according to Methanex, discriminated against foreign-produced methanol in favor of U.S. produced ethanol and was, as such, a blatant violation of Article 1102(1).

This basic contention was followed by a number of additional arguments. The purported concern with MTBE in the California groundwater was, Methanex argued, an utter contrivance, a pure sham. The University of California researchers erred when they concluded that the use of MTBE in gasoline entailed a "significant" risk of contaminating California's water resources.<sup>60</sup> This lack of scientific credibility was then compounded by the fact that MTBE in the groundwater was the result of leakage from the large number of underground gasoline storage tanks (USTs) that failed to meet state and federal safety standards. When California, instead of taking the cheaper and equally effective course of enforcing those standards, banned MTBE, ignoring the other demonstrably toxic elements leaking from the defective tanks, it became apparent, Methanex argued, that the State was not concerned with the safety of its water supply. It was instead intentionally engaged in discriminating against methanol made from foreign natural gas in favor of ethanol made entirely from U.S. grown biomass feedstock.

To punctuate this contention, Methanex charged that the California legislative process that enacted the MTBE ban was, if not strictly corrupt, unfairly prejudiced against MTBE. This prejudice, Methanex claimed, was largely fostered by the false publicity, nefarious lobbying and large campaign contributions of Archer Daniels Midland (ADM), a firm that controlled nearly seventy percent of American ethanol production.<sup>61</sup> Among ADM's more notorious interventions were its large, albeit legal, contributions to the election campaign of California Governor Grey Davis, its contributions to other California political figures and a secret meeting between Davis and ADM officers ostensibly to promote the ban.

## V. THE PARTIAL AWARD ON JURISDICTION AND ADMISSIBILITY

At this point we go back to where the United States challenged the Tribunal's jurisdiction to hear Methanex's claims. For this purpose the

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58. *Id.* at 1443.

59. *See id.*

60. *See id.* at 1459.

61. *See id.* at 1346.

United States relied on Article 1101(1) which limits the application of Chapter 11 “to measures adopted or maintained by a Party relating to: (a) investors of another Party [or] (b) investments of investors of another Party in the territory of a Party.”<sup>62</sup>

The United States argued that Article 1101(1) required a “legally significant connection” between the measure complained of—the ban on MTBE—and the loss suffered by the claimant investor.<sup>63</sup> Methanex, according to the United States, as an “investor” in methanol, a mere “feedstock” to MTBE, lacked the required “legally significant connection” to the MTBE ban. In rebuttal Methanex argued that the ban’s adverse “affect” on methanol as an MTBE feedstock sufficed to meet the relational threshold established by Article 1101(1).<sup>64</sup> The Tribunal’s initial answer to this issue came in its Preliminary Award on Jurisdiction and Admissibility of August 7, 2002 (“Partial Award”).<sup>65</sup>

The Partial Award was divided into two parts. The first related to Methanex’s so-called Original Statement of Claim, charging that the MTBE ban violated NAFTA Articles 1105 (international law) and 1110 (expropriation). The second pertained to Methanex’s Second Amended Claim charging that the discriminatory effect of the MTBE ban violated the “national treatment” mandate of Article 1102(1), the requirements of international law applicable under Article 1105(1), and the prohibition against uncompensated expropriations in Article 1110(1).

The Tribunal starts its discussion of these jurisdictional challenges by emphasizing that, in drawing the line between those consequences of a public measure that can legitimately give rise to a claim under Chapter 11 and those that are too remote, the decision-maker is required by Article 31(1) of the Vienna Convention, to attend carefully the “particular context” within which the question arose. Special care is to be given to securing a decision that would further the substantive “social polic[ies] or other value judgment[s]” of the instrument being interpreted.<sup>66</sup> This applied, the Tribunal said, whether those policies mandated an expansive interpretation of the instrument’s purview or if they necessitated “restrictions” on the “consequences for which [a particular measure was] to be held accountable.”<sup>67</sup> Having offered this framework to guide its jurisdictional inquiry, the Tribunal, in a curious reversal of form,

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62. North American Free Trade Agreement, *supra* note 7, art. 1101(1).

63. For this purpose the United States drew on cases denying third parties the right to sue for injuries sustained when another, the primary party, was victim of a contract breach or a tort.

64. See Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment at 43–46, *Methanex*, 44 I.L.M. 1345.

65. Preliminary Award on Jurisdiction and Admissibility, *Methanex*, 44 I.L.M. 1345.

66. *Id.* at 65.

67. *Id.*

appears to abandon the insight altogether when judging whether Methanex's claims came within the purview of Chapter 11.

(a) *Jurisdiction—The Original Statement of Claim*

As for Methanex's Original Claims under Article 1105 (violation of international law) and Article 1110 (uncompensated expropriation) the Tribunal makes short shrift of the jurisdictional issue. It makes no mention whatsoever of the facts, the policies, and the social values that it had earlier seemed to promise. What is offered instead is a crude caricature of an analysis. The Tribunal observes that "[t]he possible consequences of human conduct are infinite, especially when comprising acts of governmental agencies; but common sense does not require that line to run unbroken towards an endless horizon."<sup>68</sup> That's the whole of it! On the basis of this simplistic truism, and nothing more, the Tribunal announces that "it would have no jurisdiction to hear [the] claim, as pleaded in the Methanex's Original Statement of Claim."<sup>69</sup> Of course, the cognizable horizon of no remedial system is unlimited. Where that limit lies, however, is a matter for analysis within the context of the ordinance whose scope is being judged, not by a terse aphorism. The Tribunal made no attempt whatsoever to examine the functional relationship of methanol to "reformulated gasoline," or to compare that relationship with ethanol's place in the production of the same end-product or to set that relationship in the context of Chapter 11.<sup>70</sup> Perhaps there were good functional reasons to treat Methanex's original claim as falling outside the cognizance of Chapter 11. But no such reason appears in the Tribunal's explanation. There is nothing but a simplistic truism that served only to indiscriminately lump Methanol with every minor element in the reformulated gasoline chain of supply; that "endless horizon" of secondary and tertiary ingredients, their suppliers, shareholders, officers, employees, etc. This was not a discerning act of contextual treaty interpretation as contemplated by Article 31(1) of the Vienna Convention.

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68. *Id.*

69. *Id.* at 73.

70. The Tribunal was utterly indifferent to the fact that methanol is one of two basic feedstocks for MTBE, the other isobutelyn; that the United States had admitted that MTBE's was a competitor of ethanol, a product entirely of domestic origin; that before the California ban, MTBE was, by a large margin, the oxygenate of choice not only in California but throughout the United States; that methanol was the active ingredient necessary for MTBE to function as a gasoline oxygenate in competition with ethanol; that Methanex was the single largest purveyor of methanol to the California market; that methanol was the only foreign sourced ingredient of the MTBE produced by integrated refineries constituting Methanex's principal, if not only, California customers; that methanol represented one-third by weight of the final product and, by virtue of its price volatility, excised a disproportionate influence on the price of MTBE.

(b) *Jurisdiction—The Amended Claim*

The Tribunal next turned in its Partial Award to the issue of whether Methanex's Second Amended Claim<sup>71</sup> was within the scope of Chapter 11 as prescribed by Article 1101; whether California's ban on MTBE "related to" Methanex or its investment in the United States. Here Methanex had emphasized that by its ban California intended to harm foreign methanol investors in order to benefit domestic ethanol investors. The Tribunal commences its discussion by noting that, in the estimate of both parties, Methanex by this allegation changed the jurisdictional issue from that presented by its Original Claim. The parties agreed that, "[i]f the purpose of the measure is intent to harm foreign-owned investors or investments on the basis of nationality, then the measure relates to the foreign-owned investor or investment."<sup>72</sup>

The Tribunal then proceeds to review the evidence outlined in Methanex's Draft Amended Claim purporting to show California's alleged intent to harm foreign methanol producers. It concludes that while Methanex's proof might show an intent to harm foreign MTBE producers that did not suffice to show an intent to harm "suppliers of goods and services to MTBE producers," such as Methanex. But, then the Tribunal adds: "Methanex's case does not stop there. It is further alleged that Governor Davis had a broader objective: to favour ADM and the US ethanol industry, to penalise 'foreign' MTBE producers *and* 'foreign' methanol producers, such as Methanex."<sup>73</sup>

In short, what the Tribunal was later to call "malign intent,"<sup>74</sup> would suffice to bring Methanex's complaint against the ban within the scope of Chapter 11. The next step, therefore, was to test the credibility of the proof offered by Methanex on this point.<sup>75</sup> Methanex was ordered to produce a fresh pleading with accompanying evidence. Recognizing that an examination of the alleged intent to harm could also become "intertwined with the merits," the Tribunal decided to combine both in a single Final Award.<sup>76</sup>

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71. Methanex's amended claim was presented in two written submissions. The initial submission was a "Draft" of February 12, 2001 ("Draft Amended Claim" or "Draft Claim"). Draft Amendment Claim, *supra* note 53. The Tribunal had the Draft Claim very much in mind when it issued its Partial Award. In anticipation of the Tribunal's review as promised of the jurisdictional issue in its final award on the merits Methanex's second written submission was shaped largely in response to the Tribunal's Partial Award and was formally designated the "Amended Statement of Claim," dated November 5, 2002. Amended Statement of Claim, *Methanex Corp. v. United States*, 44 I.L.M. 1345 (2005).

72. Preliminary Award on Jurisdiction and Admissibility, *supra* note 65, at 73.

73. *Id.* at 75.

74. *See Methanex*, 44 I.L.M. at 1443.

75. Preliminary Award on Jurisdiction and Admissibility, *supra* note 65, at 74–75.

76. *See id.* at 77.

Apart from alleging that by its ban on MTBE California intended to harm foreign methanol producers, Methanex in its Draft Amended Claim and again in its formal Amended Statement of Claim made clear its contention that, as a foreign investor, it was in direct competition with U.S. ethanol producers and that this sufficed to bring it within the protection of Chapter 11. Not so, in the Tribunal's mind. To the Tribunal, an intent to harm foreign methanol producers—"malign intent"—would establish the jurisdictional nexus required by Article 1101(1), but market competition with domestic ethanol producers would not.<sup>77</sup> The arbitral record repeatedly establishes how utterly irrelevant the Tribunal deemed competition between methanol and ethanol to be on the question of its jurisdiction to hear Methanex's complaint.

For example, after Methanex had replied to the United States' Statement of Defense, the United States issued a Rejoinder,<sup>78</sup> noting that the Tribunal, in its Partial Award, had assumed the truth of Methanex's allegations regarding competition but had concluded that those allegations did not suffice in establishing a legally significant connection. The award held, according to the United States, that "[th]e . . . Partial Award . . . by its operative terms, excludes the possibility that the alleged "competition" Methanex now relies upon could establish the requisite connection between the measures and Methanex or its investments."<sup>79</sup>

Later, in its Final Award, the Tribunal takes particular notice of and offers no objection to the United States' statement that the Tribunal's Partial Award.<sup>80</sup>

Notably the Tribunal is careful to state that proof of an "intent to harm"—a "malign intent"—was not a necessary condition for invoking Chapter 11's grant of "direct effect."<sup>81</sup> It was, however, a sufficient condition. If proven, an "intent to harm" would establish jurisdiction. If not proven, other factors would have to be examined. However, the Tribunal categorically rejects the idea that injury to a competitive relationship could be one of those other factors. In this respect the decision is sweeping in its import. But first and foremost, it is a conceptual error of major proportions, an error aggressively repeated by the United States.

The foundation rationale for opening national markets to capital—and to goods and services—from abroad is to secure the welfare gains

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77. Nowhere does the Tribunal recognize that even if not sufficient, in itself, to establish the required relationship, the existence of a competitive relationship between foreign methanol producers and domestic ethanol producers might be considered evidence to strengthen the possibility of a required intent to harm.

78. Rejoinder of Respondent United States of America, *Methanex*, 44 I.L.M. 1345.

79. *Id.* at 17.

80. *See Methanex*, 44 I.L.M. at 1458.

81. *Id.* at 1375.



that comparative advantage makes possible. Those gains presuppose, in turn, free markets operating with the discipline, the transparency, and the efficiency that competitive markets alone can secure. While we traditionally don't express it in the following terms, it can be useful, on occasion, to recognize the fundamental fact that even if a domestic market is highly protected so long as it is also vigorously competitive nothing is to be gained by opening that market to capital or to goods and services from abroad unless the latter can bring additional competitive forces to bear; unless they put additional downward pressure on prices, enhance the quality of the goods or services being sold or the terms upon which capital is made available, or offer new products or services from which to choose. In the context of an agreement such as NAFTA the requirement that foreign investors be accorded "national treatment" represents nothing less than recognition of this elemental fact. It recognizes the need to prevent governments from interfering in the competitive process, to assure that where domestic and foreign investors are competitors in the national market the competitive relationship is not distorted by discriminatory governmental measures.<sup>82</sup> Necessarily, therefore, it is that relationship—the effect on competition of a measure such as the ban on MTBE—that must ultimately determine which foreign investors stand in an approximate enough relation to that measure to warrant extending them the right to pursue a remedy under Chapter 11.

There is absolutely no excuse for the Tribunal's failure to understand and build on this foundational principle. By the time it came to fashioning its Final Award, Methanex had called the Tribunal's attention to two lines of uncontradicted decisions establishing that, on the merits of an Article 1102(1) claim, proof that the claimant foreign investor was in competition with the domestic investor allegedly favored by the challenged governmental measure was the key to establishing that the foreign and domestic investors were "in like circumstances." The first consisted of GATT/WTO cases, the single most authoritative body of international law on "national treatment." The second consisted of decisions by other NAFTA tribunals construing Article 1102(1). These citations were then supported by citations to official studies from the United Nations Conference on Trade and Development (UNCTAD),<sup>83</sup> by the United States Department of the Treasury,<sup>84</sup> by Executive testimony

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82. The one fundamental exception to this rule is the "tariff," the tax at the border that, by definition, discriminates against the foreign-sourced product or service. Under treaties such as NAFTA and the WTO, however, while nations may discriminate by imposing tariffs against foreign competitors, they must, at the same time, be willing to put those tariffs on the table for reduction and eventual elimination through reciprocal negotiation.

83. UNITED NATIONS CONFERENCE ON TRADE & DEV., NATIONAL TREATMENT 1 (1999).

84. U.S. DEP'T OF THE TREASURY, NATIONAL TREATMENT STUDY 13 (1994).

before Congress,<sup>85</sup> and by the writings<sup>86</sup> of some of the most distinguished experts in international trade law.<sup>87</sup> If proof of competition was critical to success on the merits of a foreign investor's Article 1102(1) claim, it could hardly be less critical in assuring that a Chapter 11 Tribunal had jurisdiction to hear that claim.

How do we explain this inexcusable default? We have no reason to charge the Tribunal with incompetence or of harboring some preconceived hostility to Methanex because it challenged California's popular environmental cause. Under these circumstances, we are compelled to assign the Tribunal's profound conceptual default to its intellectual disposition. Reflective of its noncontextual formalist mind-set much of the Tribunal's Partial Award on Jurisdiction is devoted to an abstract discourse on the meaning of the phrase "relating to." For this purpose, the Tribunal purports to draw meaning out of a decision by the International Court of Justice and out of a number of legal ordinances other than NAFTA. It takes comfort in long citations proffered by the United States to show that tort, contract law, and various international delicts all limit the "remoteness of the damage" for which remedies are available.<sup>88</sup> But in this discourse the Tribunal gives no thought whatsoever to whether the circumstances attendant those references were apposite to the circumstances of the Methanex claim or, more significantly, to the purposes of NAFTA, especially Chapter 11. The Tribunal operates in an utterly abstract methodological world, paying absolutely no attention to the underlying purposes of the ordinance being interpreted and the economic and political assumptions that inform that purpose.

On a more immediate level the Methanex Tribunal's interpretation of Article 1101(1), if followed by other tribunals, could profoundly restrict the number of claimed violations of "national treatment" (Article 1102(1)) that would be cognizable under Chapter 11. In fact, the decision created a vast opening for nations to follow deliberately discriminatory (i.e., protectionist) commercial and financial policies; this is hardly a result consonant with the larger purposes of the NAFTA enterprise.

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85. *National Treatment in Policy and Practice in the United States and Abroad: Hearings Before the H. Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the H. Comm. on Banking, Finance, and Urban Affairs*, 101st Cong. 3 (1990) (testimony of David Mulford, Undersecretary of the Treasury for International Affairs).

86. R. Hudec, "Like Products": *The Differences in Meaning in GATT Articles I and III*, in *REGULATORY BARRIERS AND THE PRINCIPLE OF NON-DISCRIMINATION IN WORLD TRADE LAW* (Thomas Cottier & Petros C. Mavroidis eds., 2000).

87. The references to these several authorities by Methanex are to be found at pages 120 through 125 of Methanex's Amended Statement of Claim. See Claimant Methanex Corporation's Second Amended Statement of Claim at 120-25, *Methanex Corp. v. United States*, 44 I.L.M. 1345 (2005) [hereinafter Second Amended Statement of Claim].

88. Preliminary Award on Jurisdiction and Admissibility, *supra* note 65, at 65.

Note that the Tribunal expressly admitted that a foreign investor producing MTBE would have standing to bring a claim under Chapter 11.<sup>89</sup> We take this to mean two things. First, that a foreign investor producing the *same product* as a domestic investor would have standing to challenge a discriminatory measure against its product if that measure would distort the competitive relationship between the two. Second, a foreign investor with a product technically *different yet competitive* with that of a domestic investor could not invoke the protection of Chapter 11 even though the challenged measure was as injurious to the competitive relationship between the two as in the case of the measure targeted at the *same product*. Of course, it remains to be seen where, under this scheme, the line is to be drawn between a foreign product that is the *same* as the domestic and the merely *competitive* foreign product. The line is not self-evident.

This uncertainty aside, consider the protectionist possibilities of the distinction. A great variety of products made in the United States by foreign-owned companies are vigorously competitive with products of American owned enterprises but are mechanically, chemically, biologically, or otherwise technically very different from their American competitors. Are all these foreign investors to be denied Chapter 11 protection? If not, that would only be because of their competitive relationship to the domestic investors' product. But if, as the Tribunal makes clear, a competitive relationship cannot suffice to warrant that protection, governments are left completely free despite their "national treatment" obligation to discriminate against any foreign producer of a competitive nonidentical product that threatens their own industry.

For example, consider the pharmaceutical industry. Given the effect of the patent laws, there is a high probability that any foreign investor producing in the United States a drug functionally designed to treat the same maladies and intended to be marketed as a competitor of a product of an American owned pharmaceutical firm would nevertheless be chemically different from the latter. Would the Tribunal's formulation of Chapter 11's scope deny the foreign investor access to the rights conferred by that Chapter? If so, it would mean that a foreign investor with only a competitive product could get relief against a discriminatory measure only by persuading its own government to either espouse its cause diplomatically or pursue the offending NAFTA Member through an Article 20 arbitration. And if this is so, the Tribunal would have opened-up for the NAFTA governments a vast opportunity to employ discriminatory (i.e., protectionist) measures against foreign investors.

Moreover, unless the investor's government can find, as a predicate

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89. See *id.* at 74.

for its claim on behalf of the investor, a "national treatment" requirement in some other Chapter of NAFTA,<sup>90</sup> it will have to deal with the Methanex Tribunal's denial of jurisdiction over Methanex's Chapter 11 claim. Recall that the Tribunal's decision was under Article 1101(1). That Article applies to all claims under Article 1102(1) ("national treatment") not under just cases invoking the grant of "direct effect." In short, if the investor's own government is to pursue a claim that a treaty partner violated "national treatment" in the case of a product that is only *competitive* with that partner's product, it will have to succeed in overriding the Methanex tribunal's jurisdictional decision. That decision is not precedent but, if later tribunals have followed it, the need on the part of the investor's government to override becomes much more difficult and is likely to loom as a reason not to take-up the investor's claim, especially if that government contemplates filing a Chapter 20 arbitration. Here the irony enters.

The Methanex Tribunal's position on jurisdiction originated with counsel for the United States—members of the State Department's Legal Advisor's office. It was apparent when NAFTA was drafted and it continues to be apparent today that the flow of capital from the United States out to Mexico and Canada will, for the indefinite future, exceed by some significant margin the flow from Mexico and Canada into the United States. Unless one is prepared to attribute to the U.S. NAFTA negotiators and to the U.S. Congress that approved their draft an extraordinary naiveté or of harboring a hidden opposition to the interests of American investors, it is difficult to see how the position taken by the State Department's Legal Advisor did not directly contradict the American intentions with regard to Chapter 11, intentions in which the other NAFTA parties acquiesced.<sup>91</sup> If so, it again raises the difficult question

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90. For example, if the discriminatory measure in question applies not just to investors' investments in the offending NAFTA member but to goods imported by the investor into that country as well and the case otherwise qualifies under NAFTA Article 301(1) the government might rely on Article III(4) of GATT, which Article 301(1) of NAFTA makes applicable to intra-NAFTA trade in goods. One difficulty with this is that Article III(4) of GATT only protects "like" products not "competitive or substitutable products." Whether, for example, methanol would qualify as a "like product" to ethanol under the rather flexible interpretation that has been given that term in certain GATT decisions is an open question.

91. Again we encounter that pervasive question of why, and under what authority, does the State Department in defending the United States under a Chapter 11 challenge, advocate for interpretations of NAFTA that are plainly contrary to the best interests of the U.S. business community and of the broader foreign-policy objectives of fashioning closer and more extended economic relations between the United States and its North American partners. The issue is particularly pertinent when it is remembered that the liberal probusiness and prointegration interpretations that the legal adviser's counsel for the United States appears so reluctant to embrace were precisely the interpretations intended by both the drafters of the text and by Congress when, in furtherance of its Constitutional responsibility, it approved that text.

already alluded to. In the *Methanex* case did the Legal Advisor's office play more the role of private counsel defending a client at all costs than that of a public servant charged with furthering the public interest? And if so, is that role consonant with the broader interests of the State Department or the U.S. Executive? If not, does that signal a broader reality; as Respondent in these Chapter 11 actions can the U.S. government ever assume the broad tactical freedom of a self-interested private litigant?

These questions aside, it appears fair to conclude that in all of its work on the jurisdictional requirements of Chapter 11 the Methanex Tribunal was captive to its noncontextual formalist mind-set. It gives every evidence of an intellectual disposition that sees "law" as an autonomous social convention with its own, well-established interpretive method. This is a convention that ultimately rejects, as dangerously idiosyncratic, any interpretive process in which the meaning of words are consciously and carefully crafted to fit the potentially, sometimes very elusive, social, political, and economic premises upon which the treaty's purposes rest. It is an intellectual disposition whose rigidly narrow compass will, if allowed to prevail, ultimately undermine much of the reformative design of the NAFTA enterprise.

#### VI. MERITS OF THE "NATIONAL TREATMENT" CLAIM (ARTICLE 1102)

The Treaty provision specifically applicable to Methanex's case is Article 1102(3), which states as follows:

The treatment accorded by a Party under [Article 1102] paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.<sup>92</sup>

At this point we turn to the merits as disposed of under the Tribunal's Final Award. Here Methanex argued that it stood in "like circumstances" with United States producers of ethanol who were not subject to any ban on the use of their product as an oxygenate. Yet, that the ethanol producers were effectively Methanex's principal competitors in the California gasoline oxygenate market and competition, Methanex contended, was the key to "like circumstances." The argument, however, posed a problem. Nearly three years earlier the Tribunal in its Partial Award on Jurisdiction had unequivocally declared that proof of competition between domestic and foreign investors was irrelevant to determining whether discriminatory measures against the latter were within the

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92. North American Free Trade Agreement, *supra* note 7, art. 1102(3).

remedial powers of a Chapter 11 Tribunal.<sup>93</sup> If competition between foreign and domestic investors did not give the Tribunal jurisdiction to judge whether the California ban violated Article 1102, it is difficult to see how proof of the same competition could be used to establish that Article 1102 had been violated. Yet, Methanex pressed on, citing, as we have already seen, GATT/WTO, other NAFTA cases, and a string of authoritative statements by United Nations Commission on Trade and Development ("UNCTAD"), by U.S. executive branch representatives to Congress and by some of the world's leading trade lawyers.<sup>94</sup>

Unmoved by these authorities, the Tribunal had its own dilemma to solve. If following the logic of its Partial Award on Jurisdiction, it was necessary to discard competition as a test for when foreign and domestic investors stood in "like circumstances," the Tribunal had to devise some alternative standard for identifying which, if any, domestic investor stood within that qualifying relationship with Methanex. To this end it seized on a test proposed by the United States—the search for an appropriate "domestic comparator."

(a) *Search for the "Domestic Comparator"*

The Tribunal starts its discussion of what it called the U.S. methodology for determining "like circumstances" by noting that, in the U.S. view, "national treatment" is concerned with "nationality based discrimination" and that therefore

[t]he function of addressing [that form] of discrimination is served by comparing the treatment of the foreign investor to the treatment accorded to a domestic investor that is most similarly situated to it. In ideal circumstance, the foreign investor . . . should be compared to a domestic investor . . . that is like it in all relevant respects, but for nationality of ownership. . . .

. . . [W]here [however] there is no identical domestically-owned counterpart to the foreign-owned investment . . . a tribunal may look farther a field and expand the scope of domestically-owned comparators as long as they are similar enough to justify considering their circumstances to be "like" that of the foreign investor . . . .<sup>95</sup>

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93. This, of course, meant that the Tribunal could hear the merits of Methanex's "national treatment" complaint only because Methanex had also alleged and was being given a chance to prove that the California ban was motivated by a "malign intent" to injure foreign methanol producers and because the inquiry under this test was likely to be so entwined with the merits that the Tribunal had decided to hear both at one time.

94. See Second Amended Statement of Claim, *supra* note 87, at 120–25.

95. *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1444 (2005). The Tribunal, does, as noted, quote the statement by the United States that "national treatment" was concerned with "nationality based discrimination." If intended as a statement of the policy underlying the national treatment mandate of NAFTA Article 1102, it's pathetic and not worth a moment's attention.

The Tribunal then describes Methanex's contention under Article 1102(3) in the following terms:

Methanex and other [foreign] methanol producers [were] in like circumstances with US domestic ethanol producers because they both produce oxygenates used in manufacturing reformulated gasoline and because they compete for customers in the oxygenate market. . . . [T]he fact that methanol and ethanol are used in slightly different ways does not affect the existence of a competitive relationship . . . .<sup>96</sup>

Having reviewed these so-called "methodologies"<sup>97</sup> the Tribunal asks who is Methanex's proper comparator. Falling completely into U.S. hands, the Tribunal proclaims the death of Methanex's case:

Given the object of Article 1102 and the flexibility which the provision provides in its adoption of "like circumstances," it would be as perverse to ignore identical comparators if they were available and to use comparators that were less "like," as it would be perverse to refuse to find and apply less 'like' comparators when no identical comparators existed. The difficulty which Methanex encounters in this regard is that there are comparators which are *identical* to it.

. . . [T]here is a substantial methanol industry in the United States . . . [engaged] in marketing and production . . . just like Methanex. . . . The California ban had precisely the same effect on the American investors and investments as it had on the Canadian investor Methanex.

. . . The fact stands—Methanex did not receive less favourable treatment than the identical domestic comparators, producing methanol.<sup>98</sup>

The striking thing about this portion of the Tribunal's Final Award is that because foreign and domestic investors produce the "same" product (methanol) they are conclusively deemed to be "in like circumstances." More than that, in any case where one can identify producers of the same product, they become the only investors deemed to be in "like

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96. *Id.* at 1443.

97. Under Methanex's criteria, the "domestic comparators" would appear to include such of those U.S. owned *domestic methanol producers* that, prior to the California ban, contributed to the MTBE produced for the California reformulated gasoline market and those U.S. owned *domestic ethanol producers* that, before the ban, supplied the same California market and after the ban virtually took over that market. In the course of reviewing the Parties' different "methodologies" for determining "like circumstance," the Tribunal wrongly and very unfairly asserts that the Methanex's "methodology begins by assuming that its comparator is the ethanol industry." *Id.* at 1445. That is simply not true. Methanex starts by asserting that "competition" is the key to "like circumstances" and then proceeds to search out the domestic investor or investors that are in "competition" with foreign methanol producers. If required to follow the U.S. nomenclature, it then identifies those competitors as its "domestic comparator."

98. *Id.* at 1445.

circumstances."<sup>99</sup> The criterion of comparability is "product identity" and that criterion is preclusive of any other standard.

But why? We are never told. The hard truth is that the Tribunal tied to its noncontextual formalist convictions was unable, or unwilling, to explain in basic economic and political terms why product identity should be the talisman of "like circumstances."<sup>100</sup> Later, we shall see that it tries with utterly unconvincing results to use the NAFTA text to eliminate market competition as the criterion of comparability.

First, however, at one very simple level the conceptual defect in the Tribunal's criteria is transparent. By far the greater portion of the world's methanol production is used in the manufacture of formaldehyde, not MTBE. Suppose all of the domestic methanol producers were selling their output exclusively to formaldehyde manufacturers. In this case, no one, not even the *Methanex* Tribunal, would suggest that the domestic and the foreign producers were in "like circumstances." The domestic investors would not be subject to the ban of which the foreign investors complain and hence would not be in "like circumstances" with the foreign at least for purposes of finding a alternative "comparator" that would free domestic producers from the strictures of Article 1102(1). This simple example immediately suggests that the market in which an investor's product is sold has something to do with comparability and that, on that basis, the Tribunal would, under our simple example, be compelled to recognize domestic ethanol as Methanex's domestic comparator. Apart from the Tribunal's failure to put the Methanex case in its broader NAFTA based theoretical context, it failed simply to think through the criteria it was using.

Needless to add, the Tribunal's decision cuts deeply against the reformative and integrative force of NAFTA's "national treatment" requirement. And without question, this occurs because the Tribunal, constrained by its noncontextual formalist convictions, makes no inquiry whatsoever into the purpose of NAFTA's "national treatment" ordinance, the very ordinance it was charged with interpreting. Not a word! Not a word was said about comparative advantage and the gains to national welfare it renders possible. Apparently national economic growth is not something tribunals need worry about in settling disputes under Chapter 11. Certainly there was no reflection on the role competition might play in assuring the realization of that growth. The Tribunal

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99. There is of course no reflection on the difficulties of determining "sameness" of products. What degree of chemical, biological, mechanical, or other physical variation is still to be allowed within the definition of a particular product?

100. It is worth noting that a common product identity will not always be the basis for determining "like circumstances."



exhibits no awareness whatsoever of why a national treatment requirement might be included in an agreement concerned with investment liberalization, why it may be necessary to interdict discriminatory governmental intervention in the competitive process. And no alternative policy was offered. True, the United States described Article 1102 as “concerned with nationality based discrimination.” But if intended as policy guidance, its superficiality is shocking. It leaves the Tribunal bereft of any rational framework whatsoever for identifying the domestic investors that were in “like circumstances” with the foreign. And in consequence of this intellectual void—this inability to link national treatment with market integration—the Tribunal only succeeds in interposing the traditional boundaries of national sovereignty against NAFTA’s emphasis on continental economic integration while, in so doing, cutting deeply against “direct effect’s” assault on the realist’s political paradigm. Once again the noncontextual formalist tradition plays out as a first line of defense against a new, more democratic, more economically encompassing and disciplined system of governance for the global economy.

(b) *Competition and the NAFTA Text*

Perhaps responding to Methanex’s repeated assertion that competition was the standard for determining “like circumstances,” the Tribunal, in a classic noncontextual formalist move, attempts to demonstrate from the NAFTA text, and the text alone, that competition between foreign and domestic investors had no role whatsoever to play in making that determination. This is the Tribunal’s most extended effort to refute Methanex’s contention. As such it is an extraordinary example of textual manipulation conducted without any serious attention to the economic-political order that the text was intended to foster and the economic, political, and institutional theories that supplied the rationale for that order. The text alone determines the result and the text is pure abstraction such that the society with which it purports to be concerned is an utterly exogenous, even alien, phenomenon.

The Tribunal first notes that paragraph (1) of Article 301 of NAFTA makes the “national treatment” provisions of GATT Article III applicable to sales of goods under NAFTA. It then goes on to quote paragraph (2) of NAFTA Article 301 as follows:

The provisions of paragraph 1 regarding national treatment shall mean, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded by such state or province to *any like, directly competitive or substitutable goods, as the case*

may be, of the Party of which it forms a Part.<sup>101</sup>

The Tribunal then reviews several NAFTA Chapters<sup>102</sup> to conclude that "the drafters of NAFTA were careful and precise about the use of the words 'any like, directly competitive or substitutable goods,' on one hand, and the words "like circumstances" on the other."<sup>103</sup> "Like, directly competitive or substitutable goods"—what the Tribunal labels "trade criteria"—are never used with respect to investments. Investments together with technical barriers to trade in services are referenced solely by the words "like circumstances." The Tribunal then adds:

It may . . . be assumed that if the drafters of NAFTA had wanted to incorporate trade criteria in its investment chapter by engrafting a GATT-type formula, they could have produced a version of Article 1102 stating "Each Party shall accord to investors . . . of another Party treatment no less favorable than it accords its own investors, in like circumstances, *with respect to any like, directly competitive or substitutable goods.*" It is clear from this constructive exercise how incongruous, indeed odd, would be the juxtaposition in a single provision dealing with investment of "like circumstances" and "any like, directly competitive or substitutable goods."

. . . In any event, the drafter did not insert the above italicised words in Article 1102; and it would be unwarranted for a tribunal interpreting the provision to act as if they had, unless there were clear indications elsewhere in the text that, at best, the drafters wished to do so or, at least, that they were not opposed to doing so. In fact, the intent of the drafters to create distinct regimes for trade and investment is explicit in Article 1139's definition of investment.<sup>104</sup>

After discussing Article 1139 the Tribunal concludes:

The issue here is not the relevance of general international law . . . or the theoretical possibility of construing a provision of NAFTA by reference to another treaty of the parties, for example the GATT. International law directs this Tribunal, first and foremost, to the text; here, the text and the drafters' intentions, which it manifests, show that trade provisions were not to be transported to investment provisions. Accordingly, the Tribunal holds that Article 1102 is to be read on its own terms not as if the words "any like, directly competitive or substitutable goods" appeared in it.<sup>105</sup>

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101. North American Free Trade Agreement, *supra* note 7, art. 301.

102. The Tribunal notes that NAFTA Chapter 7, relating to sanitary and phytosanitary measures, applies "national treatment" only to "like goods," excluding any reference to "competitive or substitutable goods" and that NAFTA Chapter 9, covering standards related measures, accords "national treatment" to imports of "like goods" and to foreign service providers that stand in "like circumstances" with a domestic provider. *Methanex*, 44 I.L.M. at 1447.

103. *Id.* at 1448.

104. *Id.*

105. *Id.* at 1449.

The Tribunal's exposition is scarcely an exemplar of clarity. Nevertheless, focusing on paragraphs 34 and 35<sup>106</sup> it would seem that the Tribunal's argument goes as follows. When in Paragraph (2) of NAFTA Article 301 dealing with trade in goods, the drafters wanted to apply the "national treatment" mandate found in Paragraph (1) to both "like goods," on one hand, and "directly competitive or substitutable goods," as the case may be, on the other, they were careful to say so. Apparently in the Tribunal's mind this last phrase—"directly competitive or substitutable"—thus becomes something of a talisman—so much so that when it was not used in Article 1102, relating to investments, its absence signaled a deliberate intention by the drafters not to accord "national treatment" to foreign investors whose product was only "competitive," not identical to that of the domestic investor. The Tribunal seems to find this conclusion re-enforced by the fact that throughout NAFTA the draftsmen never used the phrase "directly competitive or substitutable goods" in connection with investments but only with regard to trade in goods. Once again we encounter a curious interpretive tendency of the Tribunal. When it finds a phrase used in one context that is absent from another, it reads that absence as signally a deliberate negative intention on the part of the drafters to exclude from the latter context the object or conduct to which the phrase relates.

In a more simplified version the Tribunal may be read as saying that, when the words "directly competitive or substitutable goods" were not included in Article 1102, it was not for the Tribunal to read those words into that Article by according equal treatment to foreign investors whose products were only "competitive" but not identical with those of domestic investors.

There are a number of problems with either of these readings of the NAFTA text. The most obvious is triggered by the words "as the case may be" in Article 301(2). These words are a clear signal that the reference to "like, directly or substitutable goods" in that Article is a response to a particular technical problem posed by Article III of GATT such that the absence of any reference to "competitive" goods in the investment Chapter of NAFTA has no significance whatsoever.

Under GATT there is a traditionally recognized but not always easily applied distinction between "like products" and "competitive or substitutable products."<sup>107</sup> Under GATT Article III "competitive or

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106. *See id.* at 1448.

107. In GATT "like products" is a term with certain flexibility. It appears throughout the GATT and tends to have different shades of meaning according to the particular textual context. Definitions tend to focus primarily on physical characteristics but in some cases consumer preference is treated as a not inconsiderable factor.

substitutable products" are granted "national treatment" protection only from discriminatory "tax measures."<sup>108</sup> With respect to all other discriminatory laws, regulations, decrees etc., the guaranty of "national treatment" extends only to "like products" not "competitive or substitutable products." Now, recall that Article 301(1) of NAFTA applies GATT Article III to trade in goods between NAFTA members and observe the function of the phrase "as the case may be" in NAFTA Article 301(2). The NAFTA draftsmen were simply making sure that in applying GATT Article III to NAFTA, if foreign goods were either "like" or "directly competitive or substitutable" with domestic goods and the domestic enjoyed a *discriminatory tax* benefit, the foreign goods would receive "national treatment" protection. If, on the other hand, the domestic goods benefited not from a tax measure but from some *other type of discriminatory regulation*, the foreign goods could claim "national treatment" protection only if the foreign goods were "like" the domestic. That's all the NAFTA draftsmen were doing. That's why they used the phrase, "as the case may be." Under Article 301(2), if the discriminatory regulation was a tax measure, then the protection was broader (it reached "competitive" goods); if it was another form of regulatory discrimination, then the protection was less expansive (it reached only "like" goods). In short, depending on the type of the discriminatory regulation, national treatment protection was to be applied either to "like" goods or to "like and competitive goods" "as the case may be." That's all. And this rule applied only to goods traded under Chapters 3 through 8 (excluding Chapter 7) of NAFTA. It did not apply to investments under Chapter 11. The point was clear. The NAFTA draftsmen were not fashioning an interpretive paradigm whose absence from Chapter 11 would signal an intent to withhold "national treatment" from foreign investors who were only "competitive" with those of a comparable domestic investor.<sup>109</sup> So much for the style of formalist construction that seems to have enamored the Tribunal.

Moreover, if the drafters were, as the Tribunal emphasized, "fluent" in GATT law, the omission from Article 1102 of the reference to "competitive" goods found in Article 301(2), may be thought to have quite a different implication. When it came to investments the drafters appear to

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108. General Agreement on Tariffs and Trade art. III, Oct. 30, 1947, 61 Stat. A3, 55 U.N.T.S. 188 [hereinafter GATT].

109. There is, in passing, a small question about "like products." Remember that the phrase in NAFTA Article 301(2) that the Tribunal thought signaled a denial of "national treatment" to "competitive" products of *foreign investors* also included "like products." Yet "like" products would certainly seem to include "identical" products under the Tribunal's "domestic comparator" test. How are the Tribunal's statutory interpretation and its analytic methodology to be reconciled? This just further evidences that the Tribunal's "domestic comparator" test and its attempt to find in the NAFTA text grounds for denying Methanex's claim are both simply not credible.

have carefully avoided referring to investors by the “products” they produced or sold, whether in terms of the very narrow GATT concept of “like products” or the somewhat more inclusive GATT concept of “competitive or substitutable” products. They chose instead a new and as yet undefined term. They spoke of investors “in like circumstances.” The word “like” imports comparability and the word “circumstances” is certainly far more capacious than merely a “type of product” however defined. “Like circumstance” could very readily encompass two firms, one domestic the other foreign, engaged in competition within the same market. Whether it does or does not is an issue to be resolved in a manner that best serves the policy underlying the grant of “national treatment” protection to foreign investors, an issue, in short, that lies well beyond the capacity of any “pure theory” of law to resolve.

That policy, in turn, engages the question of the purpose served by the grant of “national treatment” within the larger context of NAFTA’s liberalizing and market-integrating objectives. And once again we encounter the fundamental grounding of the NAFTA enterprise in the doctrine of comparative advantage and the role of market competition in assuring that the welfare gains that comparative advantage promises are fully realized. Within that construct it is critical that foreign investors are assured that the competitive vigor they bring to the domestic market is not undermined by discriminatory governmental laws and regulations.<sup>110</sup> The extent to which the Tribunal lost sight of this policy—what NAFTA was all about<sup>111</sup>—left the member nation-states free, under a broad range of circumstances, to pursue an intentionally protectionist policy

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110. Possibly one can find a justification for the Tribunal’s interpretation of Article 1102(3) by setting aside comparative advantage and adverting to a more primitive rooting in traditional mercantilism under which “national treatment” would be seen generally as a disfavored “concession” against national welfare—analogous to a tariff “concession”—justified only as a bargaining chip in obtaining like “concessions” from a foreign market. There is, however, a pragmatic problem with this rationale for a narrow reading of Article 1102(1), a reading that disregards comparative advantage and the instrumental value of competition. If we adopt the self-interest motif of the mercantilist model, it is virtually unthinkable that the United States, in its NAFTA bargain, would opt for a narrow definition of the “national interest” commitment to its investors. The bargain was with Mexico and Canada. It was then and continues to be apparent that the flow of capital from the United States out to Mexico and Canada will, for the indefinite future, exceed by some significant margin the flow from Mexico and Canada into the United States. Unless the Tribunal was prepared to credit the U.S. negotiators of NAFTA with extraordinary naiveté, the Tribunal’s narrow interpretation of Article 1102(1), seen solely as a pragmatic exercise in neomercantilist bargaining, is utterly untenable.

111. Again we encounter that pervasive question of why, and under what authority, does the State Department, in defending the United States under a Chapter 11 challenge, advocate for interpretations of NAFTA that are plainly contrary to the best interests of the U.S. business community and of the broader foreign-policy objectives of fashioning closer and more extended economic relations between the United States and its North American partners. The issue is particularly pertinent when it is remembered that the liberal probusiness and prointegration interpretations that the State Department appears so reluctant to embrace were precisely the

without having to offer any claim of public necessity for their action—nothing but unmitigated protectionism.<sup>112</sup>

(c) *Methanol and Ethanol as Competitors*

In this part of its Award, the Tribunal very briefly, and quite casually, concludes that even if arguing "competition"—what the Tribunal calls "trade law criterion"—were used to determine whether methanol and ethanol investors were "in like circumstances," it wouldn't matter because methanol and ethanol are not, in point of fact, competitive products. The argument is naïve and ultimately shows how far the Tribunal wandered from any clear understanding of the functional relationship between methanol, MTBE, and ethanol. In discussing this point, however, there is a caveat. The ensuing discussion does not purport to offer any independent judgment as to whether from all relevant market evidence methanol and ethanol were in fact competitors in the California reformulated-gasoline market. The assessment here is more limited. It is based only on such facts and arguments as are found in the Tribunal's Final Award.

Methanex starts building its case for competition by referring to its contract with the Valero Refining and Marketing Company, under which Valero had the right to reduce or cease purchase of methanol from Methanex in an amount equal to any reduction in demand for MTBE caused by "a law" adversely affecting Valero's production of and demand for MTBE in California. Under the California ban this provision would, Methanex claimed, cause Valero to "stop buying methanol from Methanex and instead buy ethanol."<sup>113</sup>

Methanex then adds a list of other major integrated California gasoline refineries that had commenced or announced a decision to com-

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interpretations intended by both the drafters of the text and by Congress when, in furtherance of its Constitutional responsibility, it approved that text.

112. Consider the case of a NAFTA member with a domestic market in which domestic and foreign investors compete vigorously but where the foreign investors product is not technically "identical" to that of the domestic investors. Under the Tribunal's interpretation of "national treatment," the NAFTA government in question can, even if foreign investors control fifty percent to eighty percent of its market, ban the foreigners outright from its market or take any other discriminatory action against them that it chooses, for any reason it chooses, provided it includes within its discriminatory decree at least one domestic firm producing a product "identical" to the foreign investors' product—one domestic investor to act as "domestic comparator" and set the standard for treatment of all foreign investors. For this pattern of discrimination the NAFTA government needs no excuse, no claim of public necessity, no need to secure a vital domestic industry, no rationale other than pure unadulterated protectionism. This also means that the only occasion when a discriminatory action against a foreign investor—even a foreign investor "identical" to a domestic investor—can violate Article 1102(1) is if the discriminatory measure is, by its terms, applicable exclusively to "foreign investors."

113. Second Amended Statement of Claim, *supra* note 87, at 30.

mence phasing out purchases of methanol to be replaced by ethanol, use of the latter presumably to be by wholesale distributors with an appropriate adjustment in the price of the base gasoline stock.<sup>114</sup> The list included British Petroleum, the largest gasoline supplier to the California market. It adds that Shell Oil was committed to entirely replace MTBE with ethanol by 2003, that Phillips Petroleum had already phased-out up to eighty percent of its MTBE production in favor of ethanol,<sup>115</sup> and that Exxon-Mobil intended to blend sixty percent of the gasoline sold in the State with ethanol by early 2003. Methanex then sums up all of this evidence by reference to a speech that the Governor of Nebraska gave in 2002 to the annual meeting of the "American Coalition for Ethanol" claiming that the replacement of methanol by ethanol in California "should create a *new* 500-million-gallons-a-year market [for ethanol]."<sup>116</sup> Largely upon this record Methanex rests its case that producers of reformulated gasoline for the California market had a "binary choice" between ethanol and methanol based MTBE as the oxygenate necessary to meet federal standards.

Methanex also pointed out that prior to the ban, MTBE was far more popular than ethanol both in California and elsewhere in the United States.<sup>117</sup> Reasons for this preference included the fact that according to one 2001 report MTBE was nearly twenty-three percent cheaper to produce than ethanol despite the significant tax credits available to the latter.<sup>118</sup> In 1997 and 1998 the California Environmental Protection Agency concluded that MTBE was the oxygenate of choice in that State because inter alia its high octane rating, beneficial "dilution effect on undesirable gasoline components," ease of mixing with gasoline, and ease of distribution.<sup>119</sup> In short, given the "binary choice" available in the market-place prior to the ban and given all the reasons for preferring methanol based MTBE, it was clear, according to

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114. *See id.* at 56.

115. In its Second Amended Statement of Claim, Methanex alleges that these three refining companies "account[ed] for 55 percent of state gasoline sales." *Id.* On the other hand, the United States in its Statement of Defense alleges that, prior to the ban on MTBE sales, the major integrated refineries in California supplied only fifteen percent of the reformulated gasoline sold in that State. Supplemental Statement of Defense on Intent of Respondent United States of America at 23, *Methanex Corp. v. United States*, 44 I.L.M. 1345 (2005). The remaining eighty-five percent, the United States alleged, was supplied by independent merchant producers of MTBE, which they then sold to wholesale distributors for insertion into basic gasoline stock to produce reformulated gasoline. These merchant producers of MTBE engaged in the purchase of both methanol and butane. They processed the latter into isobutylene, which they then reacted with methanol to yield MTBE.

116. Second Amended Statement of Claim, *supra* note 87, at 56 (alteration in original).

117. *See id.* at 57.

118. *Id.* at 36.

119. *Id.* at 35.

Methanex, that ethanol and methanol were competitive products for purposes of the "like circumstances" test under Article 1102(3).<sup>120</sup> Denial of that choice, in turn, constituted, in Methanex's view, a blatant act of discrimination in favor of investors in ethanol production—all of whom were American—against investors in methanol production—the vast majority of whom were foreign, a discrimination that patently violated Article 1102(3) of NAFTA.

Against this record as background, the Tribunal commences what is essentially a very limited discussion by noting first the United States' argument that because methanol and ethanol differ chemically and have different end-uses they are not competitive.<sup>121</sup> That methanol and ethanol differ in chemical composition is obvious. That therefore they could not be economically competitive is patently false. Markets the world over are replete with vigorously competitive products that differ sharply in their chemical composition, differences that oft-times explain both the vigor of the competition and the patents and other intellectual property rights that certify to the chemical difference. To its credit the Tribunal did not associate itself with this part of the U.S. argument.

The Tribunal did, however, embrace the end-use argument offered by the United States, stating that

[t]he incontrovertible fact is that Methanex produced methanol as a feedstock for MTBE and not as a gasoline additive in its own right. Aside from the federal prohibition of the use of methanol as an oxygenate, methanol has been tried as a fuel in only limited experiments, but would require, if it were to be used, significant and expensive retro-adjustments in gasoline engines. As a result, the ethanol and methanol products cannot be said to be in competition, even assuming that this trade law criterion were to apply. Insofar as there is a binary choice, it is between MTBE and other lawful and practicable oxygenates. Methanex's alternative theory of like products fails on the facts.<sup>122</sup>

Note that here the Tribunal acknowledges that MTBE is in competition with ethanol. Yet, to the Tribunal, the same cannot be said of methanol. The distinction is disingenuous. MTBE—produced by reacting methanol with isobutylene—is merely a vehicle used for the purpose of putting methanol into the gasoline base in order to produce "reformulated" gasoline. The Tribunal explains the technical facts requiring the use of this vehicle—this extra step.<sup>123</sup> But the whole purpose, and the only purpose, for creating the vehicle—MTBE—was to make it possible for methanol

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120. *Id.* at 125.

121. *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1446 (2005).

122. *Id.* at 1446.

123. The extra step also enhances methanol's competitiveness. The chemical conversion of



to perform precisely the same function as ethanol, namely to increase the oxygen content of gasoline in order to meet Clean Air Act standards. Under those standards either methanol or ethanol had to be used. They were functionally interchangeable. Moreover, to characterize ethanol as an “end-product” but methanol as only a “feedstock” is totally deceptive. Ethanol is not an “end-product.” No one buys “reformulated gasoline” in order to extract the ethanol. The “end-product” is “reformulated gasoline.” Ethanol, like methanol, is “feedstock” to the reformulated gasoline.

Elsewhere in the record the United States offered a related argument for denying the competitive relationship between methanol and ethanol. Among Methanex’s principal, and possibly only, California customers were the several large integrated gasoline refineries listed above, each producing substantial quantities of isobutylene as a by-product of the refining process. Before the ban on MTBE, the refineries purchased methanol from Methanex and other suppliers and reacted the methanol with isobutylene yielding MTBE, which they then added to the base gasoline stock. They then sold most of the resulting “reformulated gasoline” to wholesale distributors for resale to retail gasoline stations. When, however, the ban on MTBE necessitated the substitution of ethanol for methanol, the large California refineries discontinued adding any oxygenate to the gasoline stock leaving that task to the distributors who splash-blended ethanol into the base stock.<sup>124</sup> The reason for this was plain. Because the solubility of ethanol in water would have denied the refiners the cost-efficient use of the pipelines for transporting gasoline to the distributors, they simply declined to add ethanol to the base gasoline leaving that task to the distributors.<sup>125</sup>

The United States seized on this fact to argue that because methanol—when legal—was put into the gasoline by the refiners, while ethanol—when replacing methanol—was put in at a different stage in the supply of reformulated gasoline, methanol and ethanol could not be in competition. The argument is utterly spurious. Under Article 1102(3) the competition at issue is not competition between the several stages in the supply of reformulated gasoline—between refineries, distributors, retailers, etc. The issue is competition between two products—methanol and ethanol. These are alternative ingredients—“feedstocks”—that perform the identical function of raising the oxygen content of the gasoline to levels required by the Clean Air Act. If in performing that function they

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methanol from alcohol to either form—the production of MTBE—gives methanol an advantage over ethanol when the latter is splash blended into the gasoline.

124. Amended Statement of Defense of Respondent United States of America at 66, *Methanex*, 44 I.L.M. 1345 [hereinafter Amended Statement of Defense].

125. *Id.*

compete with each other in the market, that competition exists irrespective of the form in which they were added to the base gasoline stock, the stage in the production of gasoline at which that addition occurred and by whom.

Separate from the Final Award's discussion of whether methanol and ethanol were competitors, was one further incident worth noting. In April 1999, shortly after adoption of the regulations banning the use of MTBE by December 31, 2002 (later extended to 2003), Governor Davis applied to the Administrator of the Federal Environmental Protection Agency for a waiver from the Federal Clean Air Act regulations to allow the sale in California of nonoxygenated gasoline. The waiver was necessary, according to the Governor, because, with the ban on MTBE, California would have to turn exclusively to ethanol for the oxygenation of its gasoline and not enough ethanol was being produced in the United States to meet California's needs. The Governor's letter explained:

If MTBE is completely phased out of California gasoline . . . and the federal [reformulated gasoline] mandate is not waived, California refiners would need as much as 75,000 barrels a day of ethanol to meet demand . . . . The United States produces about 80,000 barrels per day of ethanol to meet current demand for all uses, with another 30,000 barrels per day of spare production currently idle. California will have to compete with other states if ethanol demand increases dramatically.<sup>126</sup>

Whether he chose to say so or not, practical reality made Governor Davis recognize that ethanol was a complete and practically the only substitute for MTBE.<sup>127</sup> Since, however, MTBE existed solely to facilitate the use of methanol as an oxygenate for gasoline, the Governor, effectively had to recognize that under the California ban it was methanol that was being replaced by ethanol in the California gasoline supply. One could hardly construct a closer and more precise definition of products competing in the market place.<sup>128</sup>

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126. Second Amended Statement of Claim, *supra* note 87, at 53.

127. The Governor's request for a waiver was eventually denied.

128. A not dissimilar, although less apparent and certainly unintended, recognition of the competitive relationship between methanol and ethanol is found elsewhere in the Tribunal's Final Award. Methanex had argued that the leakage of MTBE from the Underground Storage Tanks (UST) provided ADM and other ethanol interests a convenient yet utterly irresponsible pretext for attacking the methanol industry. The Tribunal commented:

The fact that the ethanol industry might see a silver lining in this crisis and anticipate economic benefits for itself if MTBE were banned from California reformulated gasoline or that the ethanol industry would support legal measures designed to accomplish this (since such measures would suit its own interests) is not by itself proof that California was engaged in a complex covert action whose objective was to help the ethanol industry and to harm methanol producers by banning MTBE.

## VII. THE ENVIRONMENTAL DIMENSION

There is little doubt that the *Methanex* case posed substantial difficulties for the Tribunal. The broad economic policy framework relied upon by Methanex may have appeared to the Tribunal as posing too grave a risk of giving "national treatment" unexplored parameters, parameters that could possibly intrude deeply into national sovereignty. Certainly Methanex's reading of Article 1102(1) intruded sharply on California's (i.e., United States') sovereignty Westphalian style, as evidenced by the political sensitivity principally, but not exclusively, within the American environmental community.<sup>129</sup> Perhaps with some justification the Tribunal was moved to find an escape.<sup>130</sup>

If so, the escape was most unfortunate. The scientific record concerning the environmental impact of MTBE, the economic analysis concerning the effects of its elimination, and the record of the intricate politics surrounding California's ban was more extensive and more carefully constructed than the record developed under any previous Article 1102 challenge by a foreign investor. Credit for this belongs principally with the Tribunal. And with that record before it the Tribunal had an unparalleled opportunity to break new and important ground in the interpretation of Article 1102, to firmly yet carefully integrate environmental considerations into the "like circumstances" inquiry. This the Tribunal refused to do.

As the record stood, methanol, as the source of oxygen in MTBE, and ethanol, as a more direct source of oxygen, certainly appeared to be "in competition" if one relies on the evidence that the Tribunal draws upon in its Final Award. In that respect, but that respect alone, Methanex certainly seemed to stand "in like circumstances" with domestic ethanol

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*Methanex*, 44 I.L.M. at 1431. Even if not treated as evidence of "covert action" to harm methanol producers, one could hardly find a clearer admission that the ban on MTBE would, to any rational mind, be of economic benefit to the ethanol industry, a "silver lining" to the MTBE leakage "crisis." One does not use words of this kind to describe disparate and completely noncompetitive products.

129. The U.S. Trade Representative was citing the case as an example of the abuse to which some multinational firms had subjected the Chapter 11 grant of direct effect. The environmentalist community in the United States was up in arms. It saw the case as another egregious example of multinational corporations using Chapter 11 to attack national environmental, health, and safety regulations. Read broadly, since none of the alleged charges leveled at ADM and others in the ethanol industry consisted of actionable bribery or the violation of any law regulating campaign contributions, the Methanex assault on that industry seemed to many a gratuitous attack on everyday practices of the American political process.

130. Here one must observe that the highly crabbed interpretation of Article 1102 offered by the United States could hardly represent the optimal reading of that provision when one considers the interests of American investors operating in Mexico and Canada. Surely the alternative reading suggested here would represent a better balance between the interests of U.S. investors abroad and protecting regulatory actions by the United States and its constituent states.

investors. When environmental circumstances are taken into account, however, that may not have been the case. The record before the Tribunal certainly contained substantial evidence to warrant the conclusion that when methanol was reacted with isobutylene in order to serve as a gasoline oxygenate (MTBE), it created an environmental problem not present with ethanol. Moreover that same record suggests rather convincingly that California, in issuing the ban, was making a scientific, good-faith, nondiscriminatory response to that same problem. Indeed, when one considers the Tribunal's very elaborate description of the evidence before it concerning the environmental impact of MTBE, one also encounters a remarkably diligent and well-balanced review of that description. Strangely, however, the Tribunal never links up the description nor the review to its analysis under Article 1102(1). Nevertheless, on the basis of this review, the Tribunal concluded (i) that the ban on MTBE originated in a policy decision of the California Senate that was motivated by a good-faith belief that California groundwater was being contaminated in a manner and to an extent that seriously threatened the California water supply and would be difficult and expensive to clean up, (ii) that any action by the California Senate on this belief was expressly made contingent upon a scientific study by the University of California, (iii) that in confirming the Senate's belief the University offered a serious, objective scientific study of a complex problem—a study tested in public hearings, by peer reviews, and through cross-examination—and (iv) there was no credible evidence that either the California Senate or the University researchers intended to favor U.S. ethanol producers or to injure methanol producers, American or foreign.<sup>131</sup> Most importantly, there is no reason to find the Tribunal offering in these conclusions anything other than a careful, fair, and thoughtful reading of the record before it.

What the Tribunal failed to do was to link up this extended and carefully crafted portion of its Award with its doctrinal analysis of "like circumstances"; it failed to consider whether by reason of the scientifically credible difference in environmental effect between methanol/MTBE and ethanol and California's good-faith response to that difference, the two products, though competitive in the marketplace, were simply not "in like circumstances" when judged by their divergent affects on the overall quality of life in California.

Perhaps, in the Tribunal's mind, opening this new and different doctrinal door looked too much like abandoning the security of legal formalism for the hazardous slopes of scientific probity and political and economic policy. There may indeed be something perilous in having

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131. *Methanex*, 44 I.L.M. at 1429.

"like circumstances" turn on scientific creditability and political good faith. Nevertheless, the Tribunal's failure to place environmental considerations squarely into the "national treatment" calculus and to articulate a formula for assaying those considerations was most unfortunate. Harm to the environment was what the case was all about. The environmental concerns were objectively genuine. The adverse political reaction to Methanex's claim was largely a reflection of those concerns. And for the Tribunal to effectively ignore the problem was to miss an important opportunity.

It must, of course, be understood that had the Tribunal opened this new door it would have been propelling "national treatment" analysis into a region of considerable subtlety. It is not always easy to differentiate between cases in which discriminatory treatment is reflective of legitimate environmental considerations and cases in which environmental considerations serve only to masque exercises in cynical discrimination. Nor is it always clear how to resolve cases where the balance between the welfare effects of environmental regulations and the welfare to be gained, especially by developing countries, from the free play of competitive markets is completely indeterminate. The GATT experience with the Article XX environmental exception, for example, is replete with such cases<sup>132</sup>—blatantly protectionist measures masquerading as environmental initiatives,<sup>133</sup> legitimate environmental regulations being administered in a subtly discriminatory manner, and cases posing an indeterminate conflict between environmental and economic rationality.

Ironically, despite the Tribunal's affinity for the NAFTA text, it totally ignored Article 1114(1) regarding environmental concerns. As part of Chapter 11 that Article provides as follows: "Nothing in this chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."<sup>134</sup>

The key words are: "any measure otherwise consistent with this

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132. GATT Article XX(g) provides:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

...

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

133. GATT, *supra* note 108, art. XX.

134. North American Free Trade Agreement, *supra* note 7, art. 1114(1).

Chapter." Plainly, these words mean that environmental limitations imposed on the free exercise of investors' rights under Chapter 11 do not automatically prevail over those rights. They must be "otherwise consistent with [that] Chapter." On the other hand, the whole purpose of Article 1114 is to make clear that, on appropriate occasion, limits imposed for environmental purposes may prevail over investors' Chapter 11 rights. The Article plainly invites some sort of mutual testing or balancing of the environmentally inspired limitations against the value or weight of the rights that would be constrained. This is precisely the calculus that governs the case of environmental constraints imposed on traders in goods under the GATT.

We, of course, are concerned here with NAFTA not GATT. Nevertheless, the fact remains that within the larger body of international economic law, GATT Article XX—especially its "chapeau"—is the most venerable repository of decisions reconciling the market opening imperatives of that agreement with what is now an ever-increasing body of environmental constraints on international trade. In the *Shrimp/Turtle* case,<sup>135</sup> the appellate body had the following to say concerning the "chapeau" of GATT Article XX:

[T]hus, a balance must be struck between the *right* of a [GATT] Member to invoke an exception under Article XX and the *duty* of that same Member to respect the treaty rights of the other Members. To permit one Member to abuse or misuse its right to invoke an exception would be effectively to allow that Member to degrade its own treaty obligations as well as to devalue the treaty rights of other Members. If the abuse or misuse is sufficiently grave or extensive, the Member in effect . . . negates altogether the treaty rights of other Members. The chapeau was installed at the head of the list of "Gen-

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135. Appellate Body Report, United States—Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R (Oct. 8, 1998). The Appellate Body in the *Shrimp/Turtle* case explained the chapeau of Article XX in the following terms:

Turning then to the chapeau of Article XX, we consider that it embodies the recognition on the part of WTO Members of the need to maintain a balance of rights and obligations between the right of a Member to invoke one or another of the exceptions of Article XX, specified in paragraphs (a) to (j), on the one hand, and the substantive rights of the other Members under GATT 1994, on the other hand. Exercise by one Member of its right to invoke an exception, such as Article XX(g), if abused or misused will, to that extent, erode or render naught the substantive treaty rights in, for example, Article XI:1, of other Members. Similarly, because the GATT 1994 itself makes available the exceptions of Article XX, in recognition of the legitimate nature of the policies and interests there embodied, the right to invoke one of those exceptions is not to be rendered illusory. The same concept may be expressed from a slightly different angle of vision, thus, a balance must be struck between the right of a Member to invoke an exception under Article XX and the duty of that same Member to respect the treaty rights of other Members.

*Id.* ¶ 156.

eral Exceptions" in Article XX to prevent such far reaching consequences.<sup>136</sup>

Implicit in a thoughtful and purposive interpretation of NAFTA Article 1114(1), lies a command to undertake a comparable analysis in cases arising under Article 1102. What makes that analysis especially difficult is the completely preclusive nature of the California ban on MTBE. To uphold the ban is to completely destroy Methanex's right, as an investor in methanol production, to produce and sell its product in California for use in making MTBE for blending with gasoline stock. Nevertheless the formula still applies, but one must also be highly sensitive to the complexity involved in implementing that formula. Facially, it would seem to involve a balancing of the total welfare gained by banning the use of MTBE in California against the welfare lost by that ban. The calculation, however, is complicated by an intermediate possibility. Could the welfare lost by the ban on MTBE have been eliminated by a regulation effectively preventing leakage from underground gasoline storage tanks? If effective prevention were possible and the cost of prevention less than the welfare lost from the ban, that would seem to merit an Award declaring the California ban on MTBE in violation of Article 1102(1).

However, before reaching any such conclusion, and in point of fact, before undertaking any of the analyses implicit in the mandate of Article 1114 and despite the inherent complexity and uncertainty of those analyses, there is an overriding problem. To what extent had the California authorities already performed something of a comparable analysis? The University of California study prepared for the California Senate not only supplied a great deal of information but analyzed that information in ways that seemed quite compatible with Article 1114. Methanex's experts also supplied considerable data and an analysis, again apparently with Article 1114 in mind. Based solely on the evidence summarized in the Final Award, all of this material leaves the impression, perhaps a strong impression, that a truly careful Article 1114 analysis would have merited a decision for the United States. But the Tribunal makes no move whatsoever to establish whether or not this was the case.

The prospect of such an inquiry, however, raises a basic issue; what deference, if any, would the Tribunal have owed the conclusions reached by the California authorities? Were the California calculations conclusive or were they entitled to no deference at all? Alternatively, should the Tribunal have simply set some methodological standards by which to judge the creditability of the California authorities' analysis? If so, what weights were to attach to particular elements in the calculus?

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136. *Id.* ¶ 156.

Moreover, the only remedy that the Tribunal could order was damages. In doing so, of course, it would have issued a decision declaring the California ban in violation of NAFTA. But what effect would that decision have had on California's conduct. Methanex would receive its damages, but California could not be ordered to terminate the ban. And Chapter 11 contains no commitment by member nation-states to conform their laws and regulations to arbitral awards. The only means that the Tribunal had to secure compliance by California with its decision was the latter's fear of future lawsuits challenging the ban; future suits by Methanex? Doubtful! Suits by other foreign methanol producers? Maybe? Or, perhaps the United States would eventually adopt a broader "foreign policy" of voluntarily complying with such decisions. There are, in short, genuine limits to a Tribunal's ability to secure Member compliance with a decision declaring their measures in violation of investors rights under Chapter 11. Perhaps this limit on its power is a further reason for any tribunal confronted by a conflict between a national environmental measure and a foreign investor's claim of right under Chapter 11, to confine itself solely to insisting first, that the member employ an analysis which in the tribunal's judgment meets the methodological requirements of Article 1114, and, second, that the analysis conducted in accord with those requirements conform to professional standards. Perhaps once assured that these points were met, the Tribunal should be content to defer to the conclusions reached by national authority, always, of course, reserving the right to over-ride any decision that appears fraudulent, prejudiced, or otherwise unjust. Critically, in short, if a tribunal feels moved by the complexities and the political, economic, and other sensitivities of a case to accord a high measure of deference to national authority, it must honestly acknowledge and justify that action both in terms of the methodology of Article 1114 and the factual record of the case. In *Methanex*, the Tribunal failed utterly to even identify the analytic process to which it was by NAFTA bound. And when it did subject the California process to scrutiny, it failed to explain if and precisely how that process did, in fact, meet the requirements of NAFTA. It was a decision that paid no attention whatsoever to NAFTA, its purposes and its environmental sensibilities. And once again there appears to be something of the Tribunal's noncontextual formalism at work in this default. For one thing, a balancing test—the "weighing" of pros and cons—is noticeably antipositivistic—law without a "rule." But more than that, the method—"weighing"—threatens to draw the decision-maker into an utterly indeterminate world of economic, political, and psychological facts and opinions. Yet, this is precisely the world framed by NAFTA, a world requiring the Tribunal to leave the comfort of its noncontextual formalism and venture out into the cold, demanding



world of judging national authority by the mandated legal fit between its actions and the attendant social order.

### VIII. ARTICLE 1105 INTERNATIONAL LAW

Methanex claimed that the California ban on MTBE violated the international-law mandate found in Article 1105(1). Probably the least important issue judged by the outcome of the case, this claim nevertheless raised some of the more intellectually interesting questions in the case, questions to which both the United States and the Tribunal responded in utterly problematic terms, proving again how unpersuasive the noncontextual formalist method can be whether by way of doctrinal analysis or textual exegesis.

Article 1105 of NAFTA provides as follows:

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.
2. Without prejudice to paragraph 1 and notwithstanding Article 1108(7)(b), each Party shall accord to investors of another Party, and to investments of investors of another Party, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil war.
3. Paragraph 2 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 1102 but for Article 1108(7)(b).<sup>137</sup>

Methanex, in three admirably short paragraphs, contended that, by its terms the reference in Paragraph (1) to "international law" and especially the requirement of "fair and equitable treatment," outlawed intentional discrimination because intentional discrimination was by definition "inequitable." Then, Methanex added, the factual demonstration already submitted under Article 1102 established a violation of Article 1105(1) by showing that the ban on MTBE was intended to discriminate against Methanex and other foreign methanol producers.

The United States answered first with an inconclusive argument based on Paragraph (3) of the FTC "interpretation."<sup>138</sup> It then offered a

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137. North American Free Trade Agreement, *supra* note 7, art. 1105.

138. There are two points to be made here. First, when the Tribunal came to considering the United States' argument, it had already determined that the California ban on MTBE did not violate Article 1102. At that point, in other words, there was no Article 1102 "determination" of breach and certainly Paragraph (3) of the FTC "interpretation" does not say that a "determination" of "no breach" of Article 1102 automatically establishes "no-breach" under Article 1105. Second, the United States' construction of Paragraph (3) is not a necessary interpretation. Assume that the word "determination" means a decision by a Chapter 11 tribunal. Accordingly, if a tribunal decides that Article 1102 has been breached, all that Paragraph (3) of the "interpretation" would

far more cogent argument invoking Article 1108 of NAFTA, but an argument largely ignored by the Tribunal.<sup>139</sup> Lastly, in what was clearly the gravamen of its defense, the United States charged that Methanex had "failed to carry its burden of proving" first that the rule of "customary international law" upon which it relied actually existed and second that the supposed rule had in fact been violated.<sup>140</sup> In dealing with the discourse on these points it is well to remember that according to the FTC "interpretation," which we are bound to take as authoritative, the reference in Article 1105(1) to "international law" is exclusively a reference to "customary international law."

In elaborating its argument, the United States, backed by impressive authority, made the critical point that "customary international law contains no general prohibition on economic discrimination against aliens,"<sup>141</sup> including presumably "intentional discrimination." Anything to the contrary would result, according to the United States, in "sacrificing important community values."<sup>142</sup> As proof of this basic assertion the United States' alluded to "State practice." Without being charged with violating international law, many nations, for example, imposed "onerous restrictions . . . on [alien] property," even to the point of excluding

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necessarily say is that the Article 1102 breach cannot automatically trigger a breach of Article 1105. This is a minimum construction of Paragraph (3). Then, Paragraph (3) would not prohibit facts, used once to determine that Article 1102 had been breached, from being used again to decide independently whether a violation had occurred under the separate criteria of Article 1105. And this latter certainly has merit since there is no intrinsic reason why nationality-based discriminatory practices that offend Article 1102 cannot also be culpable under Article 1105. This is all the more telling when it is remembered that in its Article 1102 ruling the Tribunal only extended national treatment protection to foreign investors whose products were identical to the "domestic comparator," leaving unprotected under that Article foreign investors with non-identical but competitive products. These are investors who, consistent with the basic purposes and the economic principles underlying the "national treatment" requirement, should have been prime candidates for protection under Article 1102.

139. The United States argued that insofar as Article 1108, in its list of exceptions to the rules prohibiting nationality-based discrimination, lists only Articles 1102 and 1103, not Article 1105. That indicates that the latter Article cannot be interpreted as a source of a rule prohibiting nationality-based discrimination such as the "national treatment" requirement. This follows because the Article 1108 exceptions, which are many, are generally understood as allowing member governments to engage in any and all forms of discrimination against foreign investors, foreign goods, or other foreign interests that were otherwise subject to a rule of "nondiscrimination" under NAFTA. If, on the other hand, nationality-based discrimination was, as Methanex argued, covered by Article 1105(1) and Article 1105(1) was not listed among the Article 1108 exceptions, which, the United States contended, would completely nullify the Article 1108 exceptions for Article 1102 (national treatment) and Article 1103 (MFN). In other words, the very existence of Article 1108 with no mention of Article 1105(1) indicates that the latter contained no rule prohibiting nationality-based discrimination—no "national treatment" requirement. The Tribunal made no mention of this argument.

140. Amended Statement of Defense, *supra* note 124, at 146.

141. *Id.* at 155.

142. *Id.* at 156.

aliens from "certain occupations" or from "enumerated business enterprises" or from living in or owning property in "certain geographical areas" or from "own[ing] [any] real property" at all.<sup>143</sup> On the other hand, "customary international law" did, according to the United States, establish that certain forms of discrimination did violate that law. Very limited,<sup>144</sup> these proscriptions simply did not apply to Methanex's claim.

With this contention the United States effectively posed the most salient issue raised by Methanex's attempt to invoke Article 1105(1). It starts from the premise that it would be difficult to prove that economic discrimination against aliens, either broadly conceived or more particularly as a denial of "national treatment," would violate "customary international law." In saying this we do not rely on any purported failure of the nondiscrimination principle to qualify as a traditional *opinio juris*. Anthony D'Amato has shown that as a requisite for proof of customary law, *opinio juris* is fatally circular.<sup>145</sup> We follow, instead, the suggestion by Andrew Guzman that "customary law" should be defined more in terms of community expectations; that a "state faces a norm of [customary international law] if other states believe that the state has such an obligation and if those other states will view a failure to honor that obligation as a violation."<sup>146</sup>

Yet, even after rejecting the quid pro quo argument, the picture remains complicated. The extraordinary extension of "national treatment" evidenced by the signature of the BITS and other agreements is compromised by the fact that virtually every such agreement contains lists, sometimes extensive lists, reserving the right of a particular signatory to continue denying "national treatment" to specific types of investments from one or more other signatories. NAFTA is no exception from this compromising tendency. Not infrequently the agreement may place limits, including term limits, on the reserved right to discriminate or promise to administer the discrimination more fairly and with greater transparency. Nevertheless, it is still the reservation of a right to discriminate.

These reservations, in turn, illustrate just how persistent nation-states can be in their desire to disadvantage foreign capital competitively

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143. *Id.* at 159.

144. (i) Expropriations, (ii) "denials of justice" especially denials of access to judicial remedies, and (iii) protection from "mob violence, armed conflict, or civil strife." These examples, however, were apparently the limit of what customary law prohibited. *See id.* at 160-61.

145. How can custom create new law if its critical psychological component—the "recognition" of a legal obligation—requires action in conscious accordance with existing law? *See* ANTHONY D'AMATO, *THE CONCEPT OF CUSTOM IN INTERNATIONAL LAW* 6-10 (1971).

146. Andrew T. Guzman, *A Compliance-Based Theory of International Law*, 90 CAL. L. REV. 1823, 1876 (2002).

when it enters the domestic market. This is precisely the anticompetitive persistence that Article 1102(1) was designed to contain. And it is precisely this persistence that underscores the difficulty of attributing to the otherwise nominal grants of "national treatment" contained in these agreements, evidence of a sufficient global expectation to constitute the hallmark of a "customary" norm. Indeed, the contradiction is widespread enough to suggest that "national treatment" for foreign investors will, for the indefinite future, be confined by international practice to an alternative system where growth in the law is consigned exclusively to the negotiation and enforcement of written agreements.

If correct in this, our argument supplies the final and definitive grounds for rejecting Methanex's attempt, by invoking Article 1105(1), to enlist the support of customary international law. On the other hand, if we are wrong, and "national treatment" is indeed a rule of customary law, the question in the *Methanex* case becomes whether the rule was in fact violated. And here the answer from our discussion under Article 1102(1) seems plain. Based on what we know from the Tribunal's Final Award, if "national treatment" is a recognized norm of customary law, the California ban on MTBE did indeed violate Article 1105(1), unless by reason of environmental considerations it qualified as an exception under Article 1114.

Unfortunately, neither the Tribunal nor the United States in its Statement of Defense made any effort to explore forthrightly whether a violation of "national treatment" constituted a violation of customary international law. Nor was either willing to adopt the simple device of accepting that contention *arguendo* and then dismissing Methanex's Article 1105(1) claim on the ground it had failed to prove a violation of "national treatment" under Article 1102(1). Recall, Methanex itself had rested its Article 1105(1) "international law" claim on the evidence pleaded under Article 1102(1) and the Tribunal had already dismissed the latter claim. Instead both the Tribunal and the United States contrived with arguments problematic and occasionally deceptive to avoid not only the question of whether "national treatment" constituted a norm of customary law but also whether California's ban on MTBE violated that norm.

The United States, in a gross mischaracterization of the Methanex claim, argued that the "only genre of discrimination alleged by Methanex" was "discrimination against foreign-produced goods in favor of domestically produced goods."<sup>147</sup> To remove all doubt as to what the United States meant, it added that Methanex had not been deprived of national treatment because it "[h]ad not received less favorable treat-

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147. Amended Statement of Defense, *supra* note 124, at 163.

ment than similarly-situated U.S. producers of methanol.”<sup>148</sup> This is manifestly false. The “genre of discrimination alleged by Methanex,” was discrimination against *foreign methanol* in favor of *domestic ethanol*, not discrimination against *foreign methanol* in favor of *domestic methanol*. Only by reason of this mischaracterization could the United States presume to conclude that Methanex had not been deprived of “national treatment.”

The Tribunal, on the other hand, was somewhat more forthright. Having noted that the FTC interpretation does not exclude nondiscrimination entirely from Chapter 11, it added that all the “FTC’s interpretation of Article 1105 does, in this regard, is [*sic*] to confine claims based on alleged discrimination to Article 1102, *which offers full play for a principle of non-discrimination*.”<sup>149</sup>

The claim that Article 1102 “offers full play” to the principle of nondiscrimination is simply not true if one follows the Tribunal’s interpretation of that Article. Recall, the Tribunal insisted that only technical product identity or other similarity, and not market competition, could serve as a basis for determining whether domestic and foreign investors were in “like circumstances” sufficient to assure Article 1102(1) protection for the latter. This is scarcely giving Article 1102(1) “full play.”

More importantly, this delimitation of Article 1102(1) represents a fundamental abrogation of the purposes and the underlying dynamics essential for its “national treatment” mandate to qualify as a norm of customary international law. The point is axiomatic. International capital flows can be critical to achieving the welfare gains from comparative advantage that are the first line objective of NAFTA, the BITS, and other agreements containing guaranteed investor rights. Those capital flows, in turn, are entirely dependent upon the ability of foreign investors to compete in the domestic-capital market. And “national treatment” is designed to assure that governments do not prejudice that competition. That assurance alone explains why so many agreements mandate “national treatment” and why those agreements, if sufficiently widespread without excessive reservations, may be thought adequate to qualify those mandates as reflective of customary law. The Tribunal, however, trapped by its noncontextual formalist proclivities ignores the vital importance that competition plays in furthering the policy objectives of Article 1102(1), and opts instead for an essentially meaningless product identity test, thereby stripping “national treatment” of the very dynamics essential to its acceptance as customary law, all without even addressing the issue.

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148. *Id.* at 165.

149. *Methanex Corp. v. United States*, 44 I.L.M. 1454, 1446 (2005) (emphasis added).

To support this apparent need to get rid of the bothersome question of whether "national treatment" could qualify as a rule of customary law, the Tribunal reverts to a traditional noncontextual formalist tactic. Totally without regard to the underlying economic or political objectives of the ordinance in question, the Tribunal offers an abstract textual exegesis designed to show that Article 1105(1) was totally devoid of any reference to nondiscrimination, including "national treatment." For this purpose, it makes two interpretive moves.

First, it noted that paragraph (2) of Article 1105 expressly required nondiscrimination in administering aid for wartime investment losses but that paragraph (1), upon which Methanex based its case, made no reference whatsoever to "nondiscrimination." Relying upon the interpretive canon *inclusio unius est exclusio alterius* (words included in one provision but not in another must be construed as intentionally omitted from the latter), the Tribunal concluded that, when the framers of NAFTA in mandating international law in paragraph (2) expressly referred to nondiscrimination, but when referring to international law generally in paragraph (1), omitted any mention of nondiscrimination, they signaled a deliberate decision to exclude "nondiscrimination" as a norm from that paragraph.<sup>150</sup>

This interpretive move is problematic at best. First of all, context strongly suggests that the mere mention of "nondiscrimination" in Paragraph (2), combined with the failure to mention that principle in Paragraph (1), implied no affirmative decision whatsoever to exclude it from the international law otherwise applicable under the latter. Paragraph (2) does not apply or otherwise refer to international law, whether conventional or customary. It deals with potential subsidies and other government aids for wartime investment losses. The NAFTA draftsmen clearly wanted those aids to be administered in a nondiscriminatory manner regardless of whether international law required it or not. It was, therefore, absolutely necessary to expressly mention that fact. But that necessity alone is sufficient to explain why nondiscrimination is mentioned in Paragraph (2) and not mentioned in Paragraph (1). It was absolutely necessary to (2) but not to (1) if nondiscrimination is part of the customary international law expressly referred to in that Paragraph. That explanation, in turn, eliminates any grounds for implying that the draftsmen, by their reference to nondiscrimination in paragraph (2), meant thereby to strip the international law they were applying in paragraph (1) of any rule of nondiscrimination that would otherwise be part of that law.<sup>151</sup> Once the reference to "nondiscrimination" in one paragraph is explained

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150. *Id.* at 1452.

151. This is a complex issue that is far from self-evident.

by an independent reason, its absence in another paragraph looses any negative implication it might otherwise have had. Again, careful regard to context shows how inappropriate, even dangerous, the traditional “canons” of construction can be.

Even more telling, Paragraph (2) is expressly prefaced by the words “Without prejudice to paragraph 1.” It’s as though the draftsmen anticipated the Tribunal’s argument and expressly disclaimed any such implied intention. Presumably nothing said in Paragraph (2) was to “prejudice” the content of what was said in Paragraph (1), nothing to “prejudice” the content of “international law” as traditionally understood. But that’s exactly what the Tribunal will have done by writing “nondiscrimination” and with it the “national treatment” mandate completely out of Paragraph (1), if it can be shown that discrimination against foreign investors would violate customary law.

As a second interpretive move, the Tribunal sought to reinforce its first move by going to Article 1110(1). That Article provides that for an expropriation of a foreign investor’s property to be legal it must, *inter alia*, be:

- (a) for a public purpose,
- (b) on a nondiscriminatory basis,
- (c) in accordance with due process of law and Article 1105(1),
- (d) on payment of compensation in accordance with paragraphs 2 through 6.

The two requirements—nondiscrimination and the requirements of Article 1105(1)—are placed in separate sub-paragraphs. From this the Tribunal reasons that had the draftsmen thought that “nondiscrimination” was covered under sub-paragraph (c) by the reference to “international law” under Article 1105(1) they would not have had to specifically mention it in a separate sub-paragraph (b).<sup>152</sup> The Tribunal then concludes:

This is not an instance of textual ambiguity or lacuna which invites a tribunal even to contemplate making law. When the NAFTA Parties did not incorporate a non-discrimination requirement in a provision in which they might have done so, it would be wrong for a tribunal to pretend that they had. Thus, even if Methanex had succeeded in establishing that it had suffered a discrimination for its claim under Article 1102, it would not be admissible for it, as a matter of textual interpretation, to establish a claim under Article 1105.<sup>153</sup>

Article 1110(1) reflects a view of nation-state responsibility that, for at least the last eighty years, the United States had championed as a rule of customary international law. It can be read as a substantial relin-

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152. *Methanex*, 44 I.L.M. at 1452–53.

153. *Id.* at 1453.

quishment by Mexico of its historical advocacy of the so-called Calvo doctrine<sup>154</sup> and would appear to expand the rights of foreign investors well beyond those traditionally recognized by Canada.

As a statement of the traditional United States position, Article 1110(1) quite naturally restates all of the principal elements of that position in separate paragraphs (a) to (d). Without evidence to the contrary we must assume that this format was adopted for purposes of clarity and a draftsman's sense of good order. But now the Tribunal turns this format into a substantive maneuver. It strips the concept of "nondiscrimination" in sub-paragraph (b) completely out of the "international law" applied under the reference in sub-paragraph (c) to Article 1105(1). If, according to the Tribunal, this is the necessary effect of sub-paragraph (b), the same must be true of sub-paragraphs (a) and (d). They must strip out of the reference to "international law" in sub-paragraph (c), the requirement that an expropriation be for a "public purpose" (sub-paragraph (a)) and with full compensation (sub-paragraph (d)). This alone effectively leaves the reference to "international law" in sub-paragraph (c) stripped of all the basic elements of the traditional United States position on expropriations. What's left looks like a stripped down "catch-all" for such additional points of international law as might become relevant (e.g., exhaustion of remedies, criteria for a "denial of justice").

Now, however, the Tribunal makes a remarkable move. It takes the stripped-down version of "international law" in Article 1110(c), which, by its manipulations, it has reduced to a "catch-all" for expropriation cases and substitutes that truncated version for the straight forward reference to "international law" found in Article 1105(1), itself applicable to any injury to a foreign investor in violation of that law. Even if one concedes the Tribunal's somewhat problematic assertion that by the separate reference to "nondiscrimination" in sub-paragraph (b) of Article 1110(1), the "NAFTA Parties" consciously declined to "incorporate a non-discrimination requirement in a provision in which they might have done so" (i.e., in sub-paragraph (c)), this doesn't explain why the unqualified reference to "international law" in Article 1105(1) proper should suddenly be reduced to the truncated version contrived as a mere "catch-all" for expropriation cases under Article 1110. Why should Methanex be saddled with a definition of "international law" designed for judging the legality of an expropriation? Methanex was not invoking Article 1105(1) proper, as a remedy for an expropriation. It was invok-

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154. See generally Justine Daly, *Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico After the NAFTA*, 25 ST. MARY'S L.J. 1147 (1994) (discussing Mexico's adherence to the Calvo doctrine).



ing Article 1105(1) proper to ground a claim of discrimination because it violated the “national treatment” guaranteed by international law. It may be that the “national treatment” does not qualify as a rule of customary international law. That’s a separate and real issue. But it is utterly bizarre to take the stripped-down version of “international law” contrived for expropriation cases under Article 1110(1)(c) in order to strip out from the general reference to international law in Article 1105(1), all possibility of sustaining a claimed denial of “national treatment.”<sup>155</sup>

#### IX. EXPROPRIATION IN VIOLATION OF NAFTA Article 1110

As its final claim Methanex, very succinctly, charged that the California ban on MTBE was a “taking” of its property that violated the requirements of Article 1110. The property “taken” by the ban was Methanex’s California customer base, its share of the California oxygenate market and the good will that it lost. The loss suffered was a “regulatory taking,”—what under Article 1110 qualified as “tantamount to an expropriation”—because, under the test laid down in the *Metalclad* case, Methanex was “deprived of all or a significant part of the reasonably expected economic benefits” of the property in question. To this Methanex added that because the purpose of the ban was to take the California oxygenate market away from one group of private investors (i.e., the foreign methanol producers) and give it to another group of private investors (i.e., domestic ethanol producers) it did not serve a “public purpose” as required by Article 1110(1)(a) and that as a discriminatory measure it violated the customary international law mandate of Article 1105 made applicable by Article 1110(1)(c). Finally, in Methanex’s view, as victim of a “regulatory taking” it was entitled under Article 1110(1)(d) to full compensation for its loss which obviously had not been paid.

In response the Tribunal offers a number of casual observations all of which cast doubt on Methanex’s case but provide nothing like defini-

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155. Picking-up on the United States’ argument, the Tribunal also offered the broad proposition that States are completely free to “differentiate in [their] treatment of nationals and aliens” unless bared from doing so by “a contrary rule of international law . . . whether of conventional or customary origin.” *Methanex*, 44 I.L.M. at 1454. It then notes that customary international law has established a number of such exceptions. but that, according to the International Court of Justice, the Party relying on any such exception has responsibility for establishing that it “has become binding on the other Party.” *Id.* Turning then to Methanex, the Tribunal notes that the only authority offered by Methanex for the proposition that “nondiscrimination”—presumably in the form of “national treatment”—is a component of customary international law was an extended citation from the Chapter 11 arbitration in *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/003, June 26, 2002. The Tribunal found this far from an adequate demonstration that the discrimination of which Methanex complained constituted a violation of customary international law. *Methanex*, 44 I.L.M. at 1454.

tive grounds for rejecting Methanex's claim.<sup>156</sup> Then, quite surprisingly, it offers the definitive grounds for dismissing Methanex's Article 1110(1) claim in the following terms:

In the Tribunal's view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfills a key requirement for establishing expropriations. But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, *inter alios*, a foreign investor or investment is not deemed expropriatory and compensable *unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation*.<sup>157</sup>

As with virtually all other tribunals, judicial or arbitral, domestic or international, the *Methanex* Tribunal faced a complicated problem. Historically, expropriatory actions by national governments where the owners claimed a right to compensation involved the actual assumption by the government of physical possession or the sole rights of ownership of the property in question—what the Tribunal called "expropriation simpliciter."<sup>158</sup> Against this particular form of governmental action the capital-exporting countries promoted a strong legal tradition, both international and domestic, of requiring the government to pay full compensation to the owner. While the international version of that requirement was challenged particularly by the developing countries in the United Nations General Assembly, it nevertheless seemed to retain its vitality among the various tribunals that were from time to time called to pass on the issue.

It was against this background that the developing countries increasingly found it in their interests to use regulatory intervention, rather than an outright "taking," to achieve their purposes. This included, but was never limited to, amending existing concession agreements to increase the host government's share of the profits. The response of the industrial countries was predictable. "Regulatory tak-

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156. It ambiguously casts doubt on whether customer base, market share, and good will can ever be considered "property" to serve as the object of a regulatory taking. These elements of loss, the Tribunal seems to say, might better be used in calculating damages once a "regulatory taking" is established. It also makes much of the fact that Methanex entered the United States market where it was "notorious" that not only governmental agencies, state and federal, but also media, corporations, NGO's, "and a politically active electorate [that] continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted [their use] . . . for environmental and/or health reasons." *Methanex*, 44 I.L.M. at 1456. Consistent with its earlier findings, the Tribunal dismisses what it calls Methanex's "conspiratorial thesis" concerning California's object in banning MTBE and promoting the use of ethanol. *See id.* at 1437.

157. *Id.* at 1456 (emphasis added).

158. *Id.*

ing," they contended, was as much an expropriation as the outright assumption of a possessory or ownership right and the private owner had to be compensated for any loss attributable to the regulation. This, however, created a problem as much for them as for the developing countries in which their capital was being invested. The modern nation-state engages in regulating private capital within their boundaries sometimes quite strictly. And in all nation-states regulation frequently entails financial loss to the private entrepreneur being regulated. Yet, if governments had to compensate for all such losses all of the time, the budgetary consequences would cause many governments to forego issuing otherwise vital regulations. The modern State, especially the State committed to protecting the health and safety of the mass of its population, would be crippled by any such sweeping international legal requirement, a point argued strongly by the United States in the *Methanex* case.

On the other hand, the protection of private capital, especially foreign-owned private capital, against overreaching and, at times, politically opportunistic regulation remains as necessary today as at any time in the past. Plainly, in other words, this is an area of the law requiring from judges and arbitrators alike a carefully crafted, balanced set of criteria for discerning precisely the circumstances to guide in drawing a line that will, on one hand, secure to economic activity, both within and outside a nation, its service to the public welfare while, at the same time, retaining to each nation's entrepreneurial spirit the full force of the incentives without which that spirit will inevitably languish and die. The definition of such a line is still very much in the experimental stage, and tribunals, such as the Tribunal in the *Methanex* case, have what may be thought of as a standing invitation to join the experimental process.

But it is precisely here that the Tribunal disappoints. It adverts to what can only be seen as a noncontextual formalist-inspired retreat from the challenge posed by the case presented to it. Once again the Tribunal, in an apparent search for noncontextual formalist predictability, utterly ignores, indeed offends, a fundamental purpose of NAFTA, especially of Chapter 11. Moved to enhance the welfare gains that comparative advantage promises, NAFTA clearly announces its purpose to facilitate the movement of capital between member nation-states, particularly, of course, capital from the United States and Canada to Mexico. This is the gravamen of Chapter 11. Yet, the Tribunal offers an interpretation of Article 1110(1) that could hardly pose a more insistent barrier to facilitating that purpose. If accepted as the dominant interpretation, it means that every investor is completely deprived of any protection against regulatory invasions of its property unless before making its investment it has gone to the host government "hat in hand" and asked for an agree-

ment guarantying that its investment would experience no such loss. Since the Tribunal was clearly wrong in attributing the required pre-investment agreement to current "customary international law," and presumably because Article 1110(1) supersedes any protection the investor might otherwise have obtained from customary international law, the Tribunal's holding could mean that all NAFTA investors hereafter who do not apply for or fail to obtain any such agreement would be stripped by the treaty of any right to invoke the protection of customary international law. That alone will discourage many a prospective investor from risking any significant transfer of capital from one to another Member. Moreover, the need to apply for the "permission to sue" issued by the government to be sued can all too readily be turned into a broader pre-investment approval process, a process that the framers of NAFTA fought vigorously to eliminate.

## X. CONCLUSION

NAFTA plainly shows where we must go in achieving a new, more effective and democratically controlled system of governance for the global economy. But that corner of the NAFTA experience represented by the *Methanex* case reminds us of the distance we have yet to go in fulfillment of that vision. Juxtaposed to NAFTA as harbinger of a new order, stands the grim triumvirate of traditional Westphalian conception of nation-state sovereignty, the political realists' theoretical construction of the international order, and the noncontextual formalist's theory of legal method.

The Tribunal, through its decision in the *Methanex* case, illustrates with remarkable consistency the central role that the noncontextual formalist legal method can play in a defense against NAFTA's new order. The critical consequence of the Tribunal's use of the noncontextual formalist method lies in removing the issues needing resolution from the practical purposes of the ordinance in question and from the economic, political, and cultural predicates used to both identify and shape the answers to those issues. Apparently driven by a majestic vision of law as pure essence, uncorrupted by social reality and the sometimes messy and always ambiguous context that energizes the need for and lends shape to the law, the Tribunal demonstrates rather dramatically how its vision of law provides the first line of defense in preserving both the traditional version of State sovereignty and the political realist theory of the international order, despite, in case of the latter, the contrasting force of "direct effect." All of this emerges with startling transparency from the Tribunal's refusal to place both its own jurisdiction and the "national treatment" requirement into the context of NAFTA's central economic

predicates, its inexplicable avoidance of the environmental issue raised by the sheer fact that it was an environmental measure that gave rise to the law suit, its, at times, careless use of text, and its willingness to embrace interpretations without regard for the operational consequences of its reading. In sum, NAFTA and more importantly its member nation-states were ill served by the decision in the *Methanex* case.